

Disgorgement and the CISG – Comparative and Future Perspectives

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Abstract

In the traditional contract law doctrines of both civil- and common law the liability of the party who breaches a contract is limited to paying compensatory damages for the injured party’s provable loss. According to the doctrine of disgorgement, however, the function is to strip the profits that were made through the breach.

This thesis introduces and analyzes the so-called disgorgement remedy within contract law and specifically under the United Nations Convention on Contracts for the International Sale of Goods (CISG). Closely related issues include the application and influence of the principle of good faith within the CISG and the principle of full compensation, which might preclude the applicability of disgorgement under the CISG.

The doctrine of disgorgement was not discussed at the time of drafting the CISG and therefore the question must be resolved instead through interpretation. More specifically, by virtue of the CISG’s interpretation doctrine, the interpretation shall be conducted with the help of the general principles underlying the Convention. Therefore, the principles such as good faith and full compensation and their appropriate interpretation are highly relevant to this thesis.

In order to understand the remedy and its possible operability within the CISG, this thesis provides background information about disgorgement by way of introducing different theories and viewpoints through which this remedy has been evaluated, namely theories of efficient breach and corrective justice.

As a comparative viewpoint, this thesis analyzes some of the recent developments within common law, where there has been an observable drift towards accepting disgorgement in certain limited sets of circumstances. In particular, the most articulated acceptance of the remedy in the form of Restatement (Third) of Restitution and Unjust Enrichment of the U.S. will receive considerable attention.

This thesis concludes that the interpretative analysis regarding this issue as well as the issue of good faith under the CISG need to be discussed and should preferably be also addressed by the CISG Advisory Council. Should disgorgement become feasible under the CISG, it is the writer’s contention that this would require further interpretation of Art. 84 CISG and recognition of this article as an embodiment of a general a general principle lending support for disgorgement.

Subjects and Topics

United Nations Convention on Contracts for the International Sale of Goods (CISG)

Contract damages

Disgorgement of profit

Restatement (Third) of Restitution and Unjust Enrichment (R3RUE)

Good faith

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Abbreviations

CISG / Convention – United Nations Convention on Contracts for the International Sale of Goods 1980

PECL – The Principles of European Contract Law

PICC – The UNIDROIT Principles on International Commercial Contracts (2010)

R3RUE – Restatement (Third) of Resitution and Unjust Enrichment (2011)

UCC – Uniform Commercial Code of the U.S.

ULIS – Convention relating to a Uniform Law for the International Sale of Goods (the predecessor of the CISG)

Disgorgement and the CISG – Comparative and Future Perspectives

1. Introduction

1.1 Overview of the Subject Matter and Approach

This thesis intends to lay out a thorough description of the remedial instrument known as disgorgement and the practical and principled needs it is designed to attend to, as well as to examine whether there might be a prospect of its acceptance under the United Nations Convention on Contracts for the International Sale of Goods¹ (CISG).

The policy perspectives said to underlie the stripping of profits gained from a breach of contract i.e. disgorgement, include fairness and good faith. This thesis focuses particularly on this remedy in the context of contract law and sales of goods. A closely related question arises from the traditional approach to contractual damages, going all the way to Oliver Wendell Holmes and his views regarding contract damages presented in “The Path of the Law.”²

In contract law, the duty of a party breaching a contract has traditionally been constructed as a duty to pay damages and nothing more. A possible problem emerges when the breach is motivated by an intention to reach more profits than would have been obtained by honoring the original contract. The question is whether or not a court or a tribunal can order the breaching party to hand over the profits it acquired through its breach under any circumstances. The question is fairly simple but the necessary considerations and subsequent answers are considerably more complex.

At the time of the drafting of the CISG, there existed a largely unanimous agreement about the function and nature of contract damages among the drafting parties. Thus, the issue of disgorgement was not deliberated in detail or otherwise. The eventual conclusion was that the guiding principle regarding damages under the Convention should be full compensation, meaning that the injured party should be put in a position it would have

¹ United Nations Convention on Contracts for the International Sale of Goods 1498 UNTS 3 (adopted 11 April 1980, entered into force 1 January 1988). Also referred to as “the Convention”.

² Oliver Wendell Holmes Jr., *The Path of the Law*, 10 *Harvard Law Review* 457 (1897).

been in without the breach. This rule is widely accepted within the member states comprising of different legal traditions.

However, although the full compensation principle and the restriction of damages to the extent of the actual economic loss is a relatively straightforward rule of thumb, what is worth recognizing is that possible exceptions to this rule were not discussed in detail as a separate issue at the time of drafting the CISG. There is no denying the status of full compensation as a well-reasoned principle governing the general application of the damages provisions of the CISG. But since the drafting of the CISG, questions have emerged concerning claiming the connection between verifiable loss and damages as an absolute.

A particular emphasis among the issues involved in the application of the CISG will be placed on the principle of good faith and its interpretation as well as the differently perceived viewpoints regarding this issue in common- and civil law legal systems. Indeed, the role and interpretation of good faith as a legal principle, both domestically and in international trade, has been the subject of noticeable discussion and re-evaluation.

Another issue that is touched upon is the doctrine of restitution and unjust enrichment, since certain domestic solutions concerning disgorgement in contract law have evolved partially from concepts traditionally regarded as stemming from the law of restitution. At first glance, this might seem a biased bending of existing doctrines out of place, but when reflected against the CISG's interpretational dynamics that is largely based on the inference and application of general principles, these considerations should be deemed highly relevant.

The principle of unjust enrichment undoubtedly shares elements with the arguments offered in justifying disgorgement, but the analysis will be limited on this front as disgorgement is more often than not addressed within the doctrine of damages because scholars who have contemplated this issue usually and understandably examine disgorgement through the lens of damages provisions rather than the restitution provisions. In this thesis, mostly due to the relevant comparative considerations that will be made, I will examine components from both doctrines.

Referring to the comparative considerations, in the U.S. – one of the most prominent member states as regards to economic influence³ – the tide has been turning away from the ‘Holmesian’ paradigm of contract damages. The Restatement (Third) of Restitution and Unjust Enrichment issued by the American Law Institute was published in 2011 and it laid down rules which not only enable the targeting of breaching party’s profits in specific circumstances but also sets out the general conditions under which this would be justified.

This development becomes even more interesting when we recognize the fact that as is the case with the CISG, likewise in American contract law, damages for breach of contract are based on the expectation interest rule. Thus, the view that expectation interest as the general rule of damages can coexist with the more recently recognized ‘disgorgement interest’, or rather, with more concrete manifestations of the ‘performance interest’ in specific circumstances has arguably made itself into the mainstream of contract law.

This thesis adheres to a growing and established, but sometimes overlooked, dialogue between different legal systems and, therefore, there should be no confusion of its partly comparative nature. While a substantial emphasis is placed on contract damages in common law, particularly American contract law, the primary purpose of this thesis is to examine the interpretation dynamics and future perspectives of the CISG.

Through an issue-specific and comparative approach, this paper intends to highlight and introduce viewpoints that flow either from certain universal legal theories or comparative analysis to the degree to which they might have relevance and prove useful in examining contract damages under the CISG. The intention is to supplement the analysis of the CISG in this regard by also examining viewpoints that have been developing or put forth in other contexts. I argue that such a method has the potential to broaden perspectives for academics and practitioners equally in the field of international commercial law.

As *Schwenzer* and *Hachem* have stated: “*If [the CISG] does not respond to current demands and continues to focus on the state of discussion prevalent in the 1970s (or more accurately the nineteenth century), it risks falling back into obscurity. The necessary ad-*

³ A fact that undeniably affects the U.S. legal system’s traction and influence globally and in international trade.

justments will then be made by the concurrent application of domestic remedies to precisely those cases for which the CISG was originally designed. The battle for uniformity fought by the CISG would be lost.”⁴

1.2 The CISG

The CISG has been described as “the most significant piece of substantive contract legislation in effect at the international level”.⁵ A fact that speaks for this assessment is that since its adoption in 1980, the Convention has been joined by 87 states, including all of the major industrial countries (except the United Kingdom).⁶ It is beyond any doubt that the CISG has been a great success in the field of international trade and commerce of sale of goods. It has provided a well-functioning legal tool for cross-border sales and has stood the test of time as it continues to operate in the era of economic globalization.

The international trade has benefitted from reduced transaction costs and improved legal certainty for parties involved in dispute resolution brought on by the CISG. Still, it is worthy of remembering that the CISG is essentially a delicately composed compromise between various legal systems and that as such it was not drafted to be an all-encompassing statute of law. This, in tandem with the fact that not all of the specific provisions of the CISG were discussed in detail, means that although the basic rules laid out in the CISG are clear, the same does not necessarily apply to the interpretation of those rules.

This thesis will deal with the general damages provision of the CISG, namely Art. 74, but will also examine other provisions and principles under which disgorgement of profits should be interpreted. However, the main focus of this thesis regarding the CISG will be on Art. 74 (which is said to be one of the most actively discussed and litigated provisions of the Convention)⁷ and the rules of interpretation that ultimately govern the reading of

⁴ Ingeborg Schwenzer and Pascal Hachem, ‘The Scope of the CISG Provisions on Damages’, in *Contract Damages: Domestic and International Perspectives*, at 91-105.

⁵ Joseph Lookofsky ‘The 1980 United Nations Convention on Contracts for the International Sales of Goods’, in Blanpain (ed) *International Encyclopaedia of Laws: Contracts* (Kluwer Law International, The Hague, 2000).

⁶ The complete list of all 87 contracting States is available at: http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html.

⁷ John Y. Gotanda, ‘Awarding Damages Under the United Nations Convention on the International Sales of Goods: A Matter of Interpretation’, 37 *Georgetown Journal of International Law* (2005), 95-140 at 95. See also Bruno Zeller, ‘Damages under the Convention on Contracts for the International Sale of Goods’, (2nd ed., Oxford University Press, New York, 2009); Djakhongir Saidov, ‘The Law of Damages in International Sales: The CISG and other international Instruments’, (Oxford and Portland, Hart Publishing, Oregon, 2008).

all of the Convention. As the general provision for the recovery of damages, Art. 74's interpretation is naturally of a great importance.

This thesis intends to add to the ongoing discussion about disgorgement by providing the essential background as well as introduce recent changes concerning the acceptability of disgorgement in Common law legal systems. Scholarly writings pertaining to American contract law will receive considerable attention due to the richness of its disgorgement discourse. However unorthodox this approach might appear to a devoted CISG-commentator, I feel that in order to comprehensively understand the disgorgement remedy and to eventually project this understanding into the framework of the CISG, a portion of a comparative and authentic study is called for.

As the CISG is no exception in having to evolve as new developments and challenges arise in international trade, its interpretation needs a certain amount of flexibility in order to keep up with said changes. Because one such challenge arguably stems from American contract law, we need to have a closer look at what exactly is suggested and how it is reasoned. As it turns out, one of the most prominent arguments in favor of disgorgement for breach of contract shares common ground with the ongoing debate concerning the significance of good faith under the CISG.

1.3 Structure of the Thesis

As an introduction to the remedy's origins and to the relevant terminology, this thesis will first provide an overview of the disgorgement discourse, with emphasis on the framework of American contract law (for reasons explained above), with required limitations to the subject matter in order to maintain sensible relevance to the CISG (2.).

The following part of this paper (3.) will dig deeper into the discourse by examining the most common arguments presented, both for and against disgorgement, in the relevant legal literature. After the examination of general perspectives in a comparative context of the issue, the reader will be introduced to a specific manifestation of the thus far outlined legal perspectives, namely the Restatement (Third) of Restitution and Unjust Enrichment (4.).

Finally, the thesis switches focus to the CISG and presents the basic rules regarding damages for breach of contract under the CISG (5.). From there, I will proceed to examine the relevant rules and principles governing the interpretation of the CISG (6.) as well as

analyze the most important general principles in relation to disgorgement (7.). This will be necessary in order to draw the conclusions as to what extent disgorgement could fit into the framework of the CISG and what the future might hold in this respect (8.).

Ultimately, this thesis analyzes the recent developments in the interpretation of contract law principles concerning damages. In the U.S. as well as in other common law jurisdictions, the landscape seems to be changing with respect to the dynamics of contractual damages and, for the CISG to hold its place as a relevant and efficient instrument in the long run, these changes should not be left without appropriate attention in the discussion thereof.

As disgorgement is likely to remain a controversial and debated issue, there is no immediate prospect for any definite or final conclusions to be achieved regarding the subject. However, this thesis intends to consider the possible interpretative transitions regarding the CISG that could potentially broaden the scope of full compensation from the prevailing interpretation into a more flexible one.

2. What is Disgorgement?

In order to grasp the general issue briefly presented above, it should be clarified what is meant when we are talking about disgorgement of profits. In this chapter, I will introduce the basic concept of disgorgement as a legal instrument. This will be conducted by first explaining the traditional contract law principle regarding damages for breach of contract because it was this principle that jumpstarted the arguments for recognizing disgorgement as a viable remedy.

I will also discuss the terminology regarding disgorgement. Subsequently, I describe the background and previous development of the relevant discourse originated predominantly in common law legal tradition. This chapter will close in a brief introduction of the most well-known cases which have emerged as challenging the traditional contract law approach and which have gathered much of the academic interest.

2.1 Terminology

Despite the statement made by *Lord Steyn* in the hallmark case *Attorney General v. Blake* regarding disgorgement of profits, where he stated that “*the terminology is less important than the substance*”,⁸ it is beneficial for the purposes of this thesis to provide insight to the relevant terminology in order to avoid misunderstandings and distracting polysemy.

Disgorgement of profits generally refers to stripping the gains of a wrongdoer which were made through a wrong.⁹ Correspondingly, the disgorged profit is awarded to the injured party, for as long as the award takes place in a contract law setting. Unlike damages, disgorgement is not typically available in most jurisdictions for private law wrongs such as breach of contractual obligation. Furthermore, where the remedy is available, it is usually bounded by supplementary conditions or factors that differentiate from a typical breach of contract scenario.¹⁰

⁸ *Attorney General v Blake* [2001] 1 AC 268 (H.L.), at 291.

⁹ E. Allan Farnsworth, ‘Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract’, 94 *YALE L.J.* 1339, 1341-1342 (1985); Ewoud Hondius and André Janssen, ‘Chapter 26. Disgorgement of Profits: Gain-Based Remedies throughout the World’ in Hondius E and Janssen A (eds), *Disgorgement of Profits: Gain-Based Remedies throughout the World* (Springer International Publishing Switzerland 2015), at 475-476.

¹⁰ Stephen Watterson, ‘Gain-Based Remedies for Civil Wrongs in England and Wales’ in Ewoud Hondius and André Janssen (ed.) *Disgorgement of Profits: Gain Based Remedies throughout the World* (Springer International Publishing, Switzerland, 2015), at 45-56; Mathias Siems, ‘Disgorgement of profits for breach

It should be noted that over time, there has been a number of different terms used for an award of ordering a defaulting party to give up the profits gained through a breach of contract. This type of award has also been referred to as ‘an account of profits’,¹¹ ‘restitutionary damages’,¹² and ‘disgorgement damages.’¹³

As regards the term ‘restitutionary damages’, it could be noted that both words can be misleading since the use of the word ‘damages’ is a misnomer in the sense that the term might imply that the suffered loss is the decisive factor. The word ‘restitutionary’ is faulty in its own right because the term ‘restitutionary damages’ may seem to contradict the compensatory function of damages. Furthermore, restitution is commonly understood to imply that you have to give back something to its proper owner.¹⁴ Also, avoiding the use of the word ‘restitution’ avoids confusion with the situation where a contract has been terminated because of a breach.¹⁵ Flowing from the aforementioned, one might even argue that the term ‘restitutionary damages’ is slightly paradoxical.

When it comes to the phrase “account of profits for breach of contract”, it is argued that it is not completely adequate because of its ties to equity law.¹⁶ This can be seen as having an effect on the term’s neutrality and, thereby, to its relevant applicability in current context. The term ‘gain-based damages’ has also gathered some attraction in legal literature¹⁷, but it is mostly used as an umbrella-term to describe remedies that are constructed through reference to the defendant’s gain.¹⁸

The usage of the term ‘disgorgement’ tends to differentiate between awards based upon movement of some value between the parties to a contract, which must be given back

of contract: a comparative analysis’ (2003) 7(1) *Edinburgh Law Review* 27, at 43-44; Hanoch Dagan, ‘Restitutionary Damages for Breach of Contract: An Exercise in Private Law Theory’ (2000) Vol. 1 *Theoretical Inquiries in Law* 115-154, at 116.

¹¹ Used e.g. by Lord Nicholls in *Attorney General v Blake* [2001] 1 AC 268 (H.L.).

¹² Peter Birks, ‘An Introduction to the Law of Restitution’ (Oxford: Clarendon Press, 1985); AS Burrows, ‘The Law of Restitution’ (London: Butterworths, 2nd ed, 2002).

¹³ See James Edelman, ‘Gain-Based Damages: Contract, Tort, Equity and Intellectual Property’ (Oxford: Hart, 2002).

¹⁴ Andrew Botterell, ‘Contractual Performance, corrective justice, and disgorgement for breach of contract’, *Legal Theory*, 16(3) (2010), 135-160, at 137.

¹⁵ Siems (n 10), at 28. Siems states also that there is no equivalent contradiction in concepts such as nominal or exemplary damages because they are exceptions to the general rule.

¹⁶ *Id.*, at 28-29.

¹⁷ See e.g. Edelman (fn 13); David Campbell, ‘A Relational Critique of the Third Restatement of Restitution § 39’, 68 *Washington & Lee Law Review* 1063 (2011); Caprice L. Roberts, ‘Restitutionary Disgorgement for Opportunistic Breach of Contract and Mitigation of Damages’, 42 *Loy. L.A. L. Rev.* 131 (2008).

¹⁸ Botterell (n 14), at 136.

(restitutionary award), and awards that target the gains made by the breaching party from another source, which the injured party demands to be given up (disgorgement award).¹⁹

‘Disgorgement’ is arguably the most widely spread term in relation to the issue at hand. It is also used regularly in the context of the CISG.²⁰ Due to the term’s international usage and specificity, it can be characterized as the most appropriate²¹ and, therefore, it is the word of choice of this thesis also.

Especially in the U.S, where the disgorgement discourse has arguably been the most pervasive, there has been comprehensive theorization about different variations of disgorgement in contract law as well as efforts to systematize its usage.²² It is therefore submitted that, in relation to disgorgement of profits, even under the CISG, it should be seen fruitful to introduce different viewpoints into the discussion. This is especially so when different concepts being used are overlapping and are not strictly tied to just one part of contract law in their usage. Respectively, it has been said that disgorgement is familiar to the law of restitution and rooted in unjust enrichment and has only recently started to appear more distinctly in the context of a certain set of contractual breaches.²³

Some might argue that restitution and unjust enrichment are concepts so distinct compared to the domain of contractual damages that there should be no overlapping in the analysis. This flows from a viewpoint that considers restitution and the doctrine of unjust enrichment as applicable only in circumstances where one has been unjustly enriched at the expense of the other. Furthermore, because it can be argued that with disgorgement, the profits are not made at the expense of the non-defaulting party, the injured party’s loss should be restored simply through compensatory damages.

However, there are scholars who contest this view by arguing that there are some cases in which “a party’s profitable breach of contract may be a source of unjust enrichment at the expense of the other contracting party.”²⁴ The need to locate disgorgement rigidly to

¹⁹ Adam Temple, ‘Disgorgement Damages for Breach of Contract’, *Denning Law Journal* 2008 Vol 20 pp 87-110, at 88.

²⁰ See e.g. Ingeborg Schwenzer ‘Section II. Damages. Arts. 74 –77’ in Ingeborg Schwenzer I (ed), *Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, Oxford University Press 2010 pp. 999-1049), at 1017; Ingeborg Schwenzer, Pascal Hachem and Christopher Kee, ‘Global Sales and Contract Law’ (Oxford University Press 2012); Nils Schmidt-Ahrendts, ‘Disgorgement of Profits under the CISG’ in Schwenzer I and Spagnolo L (eds), *State of Play: The 3rd Annual MAA Schlechtriem CISG Conference* (Eleven International Publishing 2012 pp. 89– 102).

²¹ Siems (n 10), at 29.

²² See generally ‘Restatement (Third) of Restitution and Unjust Enrichment’, *The American Law Institute* (St Paul: American Law Institute, 2011), Reporter: Andrew Kull (hereinafter: ‘R3RUE’).

²³ Roberts (n 17), at 145.

²⁴ R3RUE (n 22), cmt. a.

a certain field of law has been questioned by stating that "...it must be asked whether it is necessary to assign the doctrine exclusively to either the restitutionary or the contractual domain."²⁵ On one hand, disgorgement undoubtedly is a remedy for a breach of contract, but on the other hand, many instances of disgorgement relief are considered to be remedies for some type of unjust enrichment.²⁶

Generally, 'unjust enrichment' is said to occur when a defendant retains a benefit for which the defendant has not paid even though he should have. To make these definitions perhaps even more indefinite, it has been suggested that the lines between the doctrinal areas of law of restitution and contract law are not distinct.²⁷

Still, one author notes that those who use the term 'disgorgement' tend to do so for the sake of setting apart awards based on transferal of some value between claimant and defendant, which must be given back (restitution) from awards where defendant has acquired value from elsewhere and which the claimant claims to be given up (disgorgement).²⁸ In this specific sense, the concepts of restitution and disgorgement are distinct.

While this division can serve to structure the theoretical roots of the issue, the problem is that the abovementioned line has been obscured by conceptualizing the scenario where the value is collected from another source than the contract partner in a way that this conduct is still observed from the inherently bipolar perspective of the contract and the contract parties.

One example of this is the argument that when a party chooses to not to perform a contract promise and, for instance, delivers goods to a third party. This scenario can be construed through a hypothetical question of what the aggrieved party would have accepted as a price for lifting the contractual duty. Thereby, even though the benefit might have come from a third party, it cannot be completely dismissed that for the seller to reach such a benefit is contingent on breaching its original contract.²⁹

Unjust enrichment, in turn, can be briefly described as an instrument, that has evolved outside of the contract law domain, aiming to restore a sum to its original and just possessor that the defendant has unjustly received at the expense of the claimant. It differs

²⁵ McCamus, John D. "Disgorgement for Breach of Contract: A Comparative Perspective." *Loyola of Los Angeles Law Review* 36.2 (2003), 943-974, at 974.

²⁶ *Id.*

²⁷ Roberts (n 17), at 132-133, 135-136, 139.

²⁸ Temple (n 19), at 88; Botterell (n 14), at 135-137.

²⁹ John D. McCamus, 'The Restatement (Third) of Restitution and Unjust Enrichment', *Canadian Bar Review* 90.2 (2011) 439-467, at 446 (referring to the R3RUE (n 22), at 3).

from disgorgement quite significantly, as the principle of unjust enrichment does not require any wrong on the part of the defendant. In the case of disgorgement, the purpose is to take away the profit that the defendant made by wronging (breaching the contract) the claimant.³⁰ Again, some argue that the lines between the doctrines of disgorgement, contract law, restitution law and unjust enrichment are not as separate and distinct.³¹

Also, the disgorged profit does not necessarily need to be made at the expense of the injured party,³² because the remedy places its focus on the gain of the breaching party and does not require corresponding loss on the side of the claimant. Thereby, with disgorgement, it is possible that the sum awarded exceeds the loss of the claimant and thus distributes a kind of windfall profit to the injured party. Needless to say, as a possible outcome of disgorgement, this has brought the most significant amount of controversy around the subject.

2.2 Traditional Contract Law Approach

“The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, and nothing else.”³³ These oft-cited words of *Oliver Wendell Holmes* from his famous essay “*The Path of the Law*” are said to reflect conventional contract law wisdom and American law’s traditional approach to contract damages. This sentiment has also been depicted more recently: “*One is generally free to decline performance, provided that one then becomes liable to compensate the other party.*”³⁴ This kind of approach has attracted support from the academic faction of law and economics³⁵, and it has also produced a viewpoint relating to disgorgement known as the efficient breach-theory, which will be addressed in detail below.

In addition, under the traditional approach of American law, breach of contract is evaluated according to the strict liability rule.³⁶ This means that the question is whether a defendant breached as the why’s and how’s are essentially irrelevant.

³⁰ Sarah Worthington, ‘Reconsidering Disgorgement for Wrongs’ (1999) 62(2) *Modern Law Review* 218, at 220.

³¹ Roberts (n 17), at 139.

³² *Unless the breach itself as a violation of one’s rights is seen as being made “at the expense” of the non-defaulting party.*

³³ Holmes (n 2), at 462.

³⁴ Siems (n 10), at 51.

³⁵ See Richard A. Posner, ‘Economic Analysis of Law’ (7th ed. 2007), at 118-126.

³⁶ Curtis Bridgeman, ‘Reconciling Strict Liability with Corrective Justice in Contract Law’, 75 *FORDHAM L. REV.* 3013 (2007), at 3016–17.

It has been suggested that disgorgement will alter the doctrinal landscape of contract law partly because the foundational principles of the remedy conflicts with traditional contract law principles.³⁷ Contract law's principle idea concerning damages still contends that the purpose of damages is compensation.

Also, the unavailability of punitive damages for breach of contract is based on this principle.³⁸ As the function of damages in contract law is not even partly the punishing of the contract breaker, it can be construed that contract damages are focused on the claimant rather than the defendant.³⁹ Contract damages, by design, are more concerned with the aggrieved party's loss than any gain on the part of the breaching party precisely because the main goal of contract damages is and has been compensation.

As a general rule, the injured party is entitled to claim damages from the breaching party. Pursuant to established principles of contract law, the recoverable damages are compensatory in nature and are to be calculated based on the expectancy principle.⁴⁰

This principle translates to so-called expectation damages, which were articulated in a significant common law precedent in the following manner;

“where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed”.⁴¹

In other words, the claimant is deemed entitled to recover the amount of money that will place the claimant in the position she would have been in if the defendant would have fully performed his contractual obligations.⁴² This amount is often-times referred to as 'benefit of the bargain'.⁴³ Generally, this rule applies both in civil- and common law and also the CISG adheres to this rule.⁴⁴

³⁷ Roberts (n 17), at 134.

³⁸ Id., at 148-149. *For comparative study of punitive damages see* John Y. Gotanda, 'Punitive Damages: A Comparative Analysis', 42 COLUM. J. TRANSNAT'L L. p. 391 (2004).

³⁹ Roberts (17), at 148.

⁴⁰ McCamus (n 25), at 943-944.

⁴¹ *Robinson v. Harman*, (1848) 154 Eng. Rep. 363, 365 (Exch.). In similar vein see *Franklin Fed. Sav. Bank v. United States*, 55 Fed. Cl. 108, 114 (2003) ("One approach [to breach-of-contract damages] is to give the nonbreaching party the benefits he or she expected to receive had the breach not occurred, also known as the 'benefit of the bargain'").

⁴² McCamus (n 25), at 944.

⁴³ CISG Advisory Council Opinion No. 6, 'Calculation of Damages under Article 74 CISG', Rapporteur: Professor John Y. Gotanda. Adopted by the CISG Advisory Council at its Spring 2006 meeting in Stockholm, Sweden, at 3.1.

⁴⁴ Id. (fn 3): *Keneric Tractor Sales Ltd. v. Langille*, [1987] 2 S.C.R. 440 (Can.); *Wertheim v. Chicoutimi Pulp Co.*, [1911] A.C. 301 (P.C. 1910) (Eng.); *Robinson v. Harman*, 154 Eng. Rep. 363 (Ex. 1848).

As compensatory damages are based on the notion that compensation is meant to undo the adverse effects the breach has caused to the aggrieved party, they can be described as centered around the aggrieved party. Their rationale is to measure the loss incurred by the aggrieved party and then restore that amount. In contrast to the traditional compensatory viewpoint, disgorgement is interested in the defendant's gain.

Disgorgement can be described as a form of gain-based damages as it focuses on the gain or benefits the breaching party has 'wrongfully' obtained. Therefore, even if disgorgement for a breach of contract could be awarded without the intention of punishing the breaching party, the remedy undoubtedly shifts the focus from the claimant's loss to the gain of the defendant.⁴⁵

It follows from this that disgorgement does not fall under the general term 'compensatory damages', even though it might achieve compensating the aggrieved party in the process.⁴⁶ Also, it should be noted that if the amount of loss is quantified through reference to the breaching party's profit, it does not automatically render the award as disgorgement. Instead, this can be seen merely as a method for quantifying damages as long as it can be reasonably proven that the amount of the profit reflects the amount of the loss.

Traditionally, disgorgement has not been available for a breach of contract. In most countries, the orthodox remedial response to a contract breach is that the claimant is able to receive compensation for the loss he or she has actually suffered. Correspondingly, focusing on the profit received by the defendant is seen as inappropriate. Nevertheless, there are arguments defying this "monopoly of compensation" regarding contract damages put forth in varying decisions and scholarly writings that support the contention that in some cases, the injured party should be able to claim the benefit that the other party has achieved through a breach of contract.⁴⁷

However, there are various justifications for the traditional approach. Some are anchored to the 'Holmesian' view of contract damages. Holmes, perhaps even more farsightedly than he might have realized, thought that the doctrine he subscribed to "stinks in the nostrils of those who think it advantageous to get as much ethics into the law as they can."⁴⁸

⁴⁵ Roberts (n 17), at 150; CISG Advisory Council Op. No. 6, at 1.1, 3.1.

⁴⁶ Stephen Waddams, 'Gains Derived from Breach of Contract: Historical and Conceptual Perspectives' in Saidov D and Cunnington R (eds), *Contract Damages: Domestic and International Perspectives* (Hart Publishing 2008) 187-206, at 193.

⁴⁷ Siems (n 10), at 28.

⁴⁸ Holmes (n 2), at 462.

As a criticism, Holmes' assertion that contractual obligation as a duty should be constructed in terms of having the option between performance and damages has been evaluated as "circular and unconvincing".⁴⁹ Respectively, favoring gain-based damages is said to be linked to strong ethical intuitions such as emphasizing the binding nature of contracts in that promises should be kept and that contract-breakers should not be allowed to profit from their wrongs.⁵⁰

Holmes' view has been seen to implicitly include a more persuasive argument for the traditional approach. That is so because many breaches do not involve any form of bad faith. It would seem that in these cases compensatory damages are justified also from an ethical perspective. Arguably, more burdensome awards might be appropriate when there is unquestionable moral blame on the side of the breaching party, but if this suggestion were to be accepted, it would introduce undue uncertainty, in form of ethical evaluation, into the contract law system. And this is exactly what limiting damages only to compensation achieves to avoid.⁵¹ Those who argue for the recognition of disgorgement are less troubled by this issue and some would favor a test based on moral culpability (good-/bad faith considerations) for the availability of disgorgement.⁵²

Incidentally, to some extent, the willingness of courts to apply standards based on requirements to act in good faith has been increasing, which suggests that issues of moral culpability are not precluded from judicial evaluation in the contractual context.⁵³ Indeed, the pervasive but rather elusive question concerning the principle of good faith in contract law is arguably a major issue underlying the disgorgement debate and as such it will be discussed in detail below.

Naturally, the role of good faith, as well as its development under the CISG will be examined due to its principal connection to the issue at hand. Different standpoints in the interpretation of good faith principle under the CISG might have varying implications regarding disgorgement as well.

⁴⁹ McCamus (n 25), at 948.

⁵⁰ Ernest J. Weinrib, 'Punishment and Disgorgement as Contract Remedies' (2003) 78 *Chicago-Kent Law Review* 55, at 71.

⁵¹ McCamus (n 25), at 948-949.

⁵² Peter Birks, 'Restitutionary Damages for Breach of Contract: Snep and the Fusion of Law and Equity', (1987) *LLOYD'S MAR. & COM. L.Q.* 421, at 442.

⁵³ See Shannon Kathleen O'Byrne, *Good Faith in Contractual Performance: Recent Developments*, 74 *CAN. BAR REV.* 70, 93-94 (1995); McCamus (n 25), at 949 (fn 17).

3. The Disgorgement Debate

After establishing the basis for our discussion of disgorgement, this chapter will now proceed to present the various arguments made for and against this rather controversial remedy in the context of contractual damages. This chapter will review relevant legal literature as well as the different concepts, theories, proposals and viewpoints presented therein.

This will include a brief overview of the origins of disgorgement's development (3.1). I will then introduce the basic concepts regarding the efficient breach theory (3.2) and the corrective justice theory's account on the subject (3.3). These two theoretical perspectives have been chosen for their prominence within the discourse around disgorgement and equally importantly because of their universal nature as they are not attached to any specific legal system.

This chapter is intended to provide a summary of the essential ideas presented by the legal scholars in this field. This should provide us the proper vehicle to eventually move into the evaluation of the CISG and its interpretation with the required background perspective. Before that, we are able to review the specific solution offered for the disgorgement 'debate' in the U.S. with the appropriate background knowledge.

3.1 The Origins of Disgorgement

By and large, disgorgement has originated from the restitution doctrine of common law and more specifically from restitution in the context of contract law. This notion is based on a shared fundamental purpose between disgorgement and other restitutionary claims: to "prevent the defendant's unjust enrichment by recapturing the gains the defendant secured in a transaction."⁵⁴ While the traditional claim for damages is seeking to measure the claimant's loss and subsequently compensate that loss, restitution measures the defendant's gain and requires the defendant to disgorge the gains attributable to the subject transaction or wrongdoing.⁵⁵

⁵⁴ Restatement (First) of Restitution § 1 (1937), cited in: Dan B. Dobbs, 'Law of Remedies: Damages-Equity-Restitution' (2d ed. 1993), at 551–552.

⁵⁵ See *id.*, at 555-556.

Recently, the law of restitution in common law has gathered much attention amongst Anglo-American scholars and judiciary, specifically because of the debate regarding the issue of whether or not disgorgement can supplement traditional contract remedies in the setting of breach of contract.⁵⁶ The question of applicability of disgorgement has been described as surrounded by controversy⁵⁷ and “devilishly difficult”.⁵⁸

In contract law, the traditional restitution alternative to a claim for damages has been the option of the injured party to treat the contract as discharged⁵⁹ in certain circumstances, because of the breach and thereby demand restitution of the benefits that the injured party had already transferred to the party in default. Some suggest that this kind of recovery is made possible in order to avoid the unjust enrichment of the breaching party.⁶⁰

However, this is not entirely what disgorgement is about. Disgorgement would provide a further alternative for the injured party to bring a claim for an award to recover the benefits acquired by the breaching party through its contract breach.⁶¹

3.1.1 Disgorgement Outside Contract Law

It is worth noting that before entering into the realm of contract law, disgorgement had established itself as a legitimate instrument in various fields of common law.⁶² One such example is where a party has profited by breaching its fiduciary duties. The fiduciary is normally made to disgorge all of the profits earned, even when there is no corresponding loss or expense on the side of the beneficiary. Similar rules can be found in doctrines relating to tortious wrongs, breaches of confidence and, although further from private law, profits of crime.⁶³

In the law of fiduciary obligations, disgorgement is an important remedy. If a fiduciary breaches his fiduciary obligation to achieve personal gain by abusing his position, property or information entrusted to him, he must be subjected to disgorgement of that gain and surrender it to his beneficiary even if the beneficiary has not suffered any loss in the

⁵⁶ Dagan (n 10), at 116.

⁵⁷ McCamus (n 25), at 943.

⁵⁸ Andrew Burrows, ‘No Restitutionary Damages for Breach of Contract’, 1993 LLOYD’S MAR. & COM. L.Q. 453, cited in: Weinrib (n 50), at 70.

⁵⁹ Cf. CISG’s terminology: ‘avoided’.

⁶⁰ McCamus (n 25), at 944.

⁶¹ Id., at 944-945.

⁶² Melvin A. Eisenberg, ‘The Disgorgement Interest in Contract Law’, 105 Mich. L. Rev. 559 (2006), at 563.

⁶³ McCamus (n 25), at 945-946.

process. The applicability of disgorgement in cases involving fiduciary obligations derives from the relationship's special nature in terms of trust and vulnerability. In fiduciary context, it is especially persuasive idea that one should not profit from one's wrongful conduct.⁶⁴

Secondly, requiring disgorgement is said to materialize the implicit expectations of the beneficiary by way of shaping the conduct of fiduciaries to better reflect those expectations and by providing the fiduciaries with the right incentives.⁶⁵

Disgorgement can also be awarded when questions regarding property interests or rights are involved. One such instance is where a wrongdoer appropriates owner's property. The wrongdoer is liable for the owner's loss in conversion and the damages are normally calculated by referring to the market price at the time of the conversion. But if the property is subsequently sold at a higher price by the wrongdoer to a third party, the aggrieved owner can take action to require the disgorgement of that price instead of the owner's own loss. Also, an owner of a property can require disgorgement of wrongfully obtained (in violation of owner's property rights) rental value of the property, even if such value would exceed the market price of the property.⁶⁶

In this light, if disgorgement is available for breach of fiduciary obligation, breach of confidence, tortious wrongdoings and, to some extent, in contractual settings to protect proprietary interests, it seems unclear why a similar remedy should be entirely precluded when it comes to a purely contractual breach.⁶⁷ On the surface, it might seem confusing that proprietary interests are protected by disgorgement while the same level of protection is categorically refused in cases concerning breach of contract.⁶⁸

In a similar vein, refusal to grant disgorgement has even been considered as indirectly allowing the breaching party to "expropriate" the contractual rights of the promisee.⁶⁹ Admittedly, this view can be seen as fair in cases where damages based on expectancy principle would constitute in no compensation whatsoever. It has also been noted that *the*

⁶⁴ This is a general principle and as such it is not confined in law of fiduciary obligations. The principle is often invoked also in support of disgorgement in contract law and it will be elaborated in subsequent chapters.

⁶⁵ Robert Cooter & Bradley J. Freedman, 'The Fiduciary Relationship: Its Economic Character and Legal Consequences', 66 N.Y.U. L. REV. 1045 (1991), at 1049-1056.

⁶⁶ Eisenberg (n 62), at 563-564.

⁶⁷ McCamus (n 25), at 951-952.

⁶⁸ Id., at 952; Lionel D. Smith, 'Disgorgement of the Profits of Breach of Contract: Property, Contract and "Efficient Breach"', 24 CAN. Bus. L.J. 121 (1994-95), at 129-132.

⁶⁹ McCamus, Disgorgement for Breach of Contract: A Comparative Perspective, at 951-952.

*impulse to grant disgorgement to achieve a just result in an individual case can be so strong that courts have occasionally, and to some extent arbitrarily, constructed concepts of fiduciary obligation and compensation to indirectly achieve the same results as with disgorgement.*⁷⁰

Based on this observation, it can be argued that a clearer recognition of disgorgement for contract breach on a principled level would result in a more fruitful discussion about the specific situations and circumstances in which disgorgement could be appropriate and made available.⁷¹

Regarding the comparison between standard contract law remedies and cases involving proprietary interests, it must be pointed out, however, that the special nature and status of proprietary interests are well recognized as the field of property law holds and adheres to its own foundational problems and concepts. In common law⁷², property rights are typically protected by the availability of (equitable) specific performance and injunctions when ordinary claim for damages is deemed inadequate to protect such interests.⁷³

Therefore, in cases that involve proprietary interests, disgorgement should arguably be seen as an alternative response to the problem concerning the inadequacy of compensatory damages where specific performance would be either impossible, unduly burdensome or, for some other reason, unsuitable.⁷⁴

As for the U.S. legal system, and in relation to the percolation of disgorgement from other fields of law and into contract law, one comment in the Restatement (Third) of Restitution and Unjust Enrichment describes the current state of affairs in the following manner: “Increased scholarly attention to the question [of disgorgement] in recent years has nevertheless produced a consensus that it is appropriate to treat a deliberate and profitable breach of contract by analogy to an intentional and profitable interference with other legally protected interests.”⁷⁵

⁷⁰ Smith (n 68), at 126-129.

⁷¹ McCamus (n 25), at 952.

⁷² *Predominantly in civil law legal systems as well.*

⁷³ See e.g. Hanoch Dagan (n 10), at 132-139; Restatement (Second) of Contracts §§ 357, 359(1). Interestingly, disgorgement is not clearly categorized to either ‘equitable’ or ‘legal’ remedies: “*Disgorgement never solidified as a pure equitable or legal remedy. Rulings are inconsistent given the functional appearance of disgorgement as a monetary award. The Restatement (Third) of Restitution classifies the disgorgement remedy as legal. Most courts, however, view disgorgement as equitable given its historical affiliation with the equitable remedy of accounting.*”, Caprice L. Roberts, ‘Supreme Disgorgement’, 68 Florida Law Review (2016), at 1426-1427.

⁷⁴ McCamus (n 25), at 958.

⁷⁵ R3RUE, §39, Reporter’s Note, at comment a.

A relevant observation regarding the latter part of this thesis is that, unlike any other common law country, the U.S. has adopted the principle of good faith in its Uniform Commercial Code and the Restatement (Second) of Contracts.⁷⁶

3.1.2 Disgorgement's Advancement into Contract Law – Introduction to the *Blake v. Attorney General* and the *Adras v. Harlow Jones*

There are two cases that have attracted much of the academic interest in the discourse about disgorgement. This subchapter will briefly introduce these to the reader for their influential nature as precedents, most of all in legal literature.⁷⁷ The *Blake v. Attorney General* case⁷⁸ (Blake case) is referenced in practically every piece of common law legal literature pertaining to disgorgement. Respectively, the case of *Adras v. Harlow & Jones*⁷⁹ (Adras case) holds a similar status within the CISG literature.

The setting of the Blake case was that a spy for British intelligence services named George Blake turned out to be a double-spy in that he also spied for the Soviet Union. When his crimes were revealed, he was imprisoned but subsequently managed to escape. The case dealt with the appropriate legal reaction to profits that Blake made by writing and having published his memoirs. By writing and publishing the book, Blake clearly violated his confidentiality duties of his employment contract with the Crown.

Thus, the Attorney General was certainly in a position to bring a claim against Blake for damages for breach of contract. Although, if damages were to be calculated on the basis of the expectancy principle, the Crown would not have been able to establish a compensable loss. Notwithstanding, if Blake had performed his contract with the Crown, he could not have written the book and he would not have earned any profits. In these exceptional circumstances, the House of Lords decided to order the disgorgement of Blake's profits and the famous precedent of granting disgorgement under the British contract law was made.

⁷⁶ See U.C.C. 1-203 (1978) ("*Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement*"); Restatement (Second) of Contracts, 205: ("*Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.*").

⁷⁷ For other prominent cases see e.g. *AB Corp. v. CD Co. (The Sine Nomine)*, [2002] 1 LLOYD'S REP. 805, 806 (stating that in an exceptional case a plaintiff could "obtain wrongful profits as damages for breach of contract," but that in this particular case, an efficient breach did not require disgorgement); *Snepp v. United States*, 444 U.S. 507 (1980).

⁷⁸ *Attorney General v Blake* [2001] 1 AC 268 (H.L.).

⁷⁹ *Adras Construction Co. Ltd. v. Harlow & Jones* (ISR, 1988).

The Adras case, in turn, dealt with a second sale setting and was ruled under the predecessor of the CISG, namely the ULIS.⁸⁰ Put briefly: the Supreme Court of Israel decided to override ULIS and apply the country's domestic law instead to the effect of the principle of unjust enrichment manifesting in an award of disgorgement, despite the fact that the contract between the parties was not effectively avoided. This approach was strongly criticized as "being inconsistent with the objective of ULIS to provide uniformity in international trade law".⁸¹

Schlechtriem had a strong opinion about the Israeli case. He underlined that "*The same rule of priority of the Convention should apply if issues regulated by the Convention could lead to a remedy under domestic law which is inconsistent with the Convention. A good example is the Israeli case...*". He also stated that the uniformity achieved by the Convention would have been in grave danger if national provisions could be applied in such instances, commenting on the ruling that "*In this instance, the rules of the Convention and its requirement for certain remedies were pushed aside by a restitutionary remedy under domestic law.*"⁸²

The Adras Case is a good example in highlighting the risk of courts resorting to domestic law in that case when the international law did not provide for disgorgement of profits. Issues relating to the uniformity requirement in the interpretation of the CISG will be discussed below in chapters 6 And 7.

3.2 Efficient Breach Theory and Disgorgement

Of the different critiques of allowing the disgorgement measure in contract law, perhaps the most well-known is the so-called efficient breach theory. It takes the ethical paradigm that no one should benefit from their wrong-doing and turns it around by assessing contract breaches from efficiency-perspective. The theory has its roots in the field of law and economics and one commentator has stated that: "*Law and economics scholarship has advanced a number of provocative arguments in the name of efficiency but none is perhaps quite so controversial as the argument behind the efficient breach hypothesis.*"⁸³

⁸⁰ Convention relating to a Uniform Law on the International Sale of Goods, The Hague, 1 July 1964, United Nations, *Treaty Series*, vol. 834, at 107.

⁸¹ Arie Reich, 'Headnote on Adras Construction Co. Ltd. v. Harlow & Jones GmbH'.

⁸² Peter Schlechtriem, 'Uniform Sales Law, The Experience with Uniform Sales Laws in the Federal Republic of Germany', in: *Juridisk Tidsskrift*, Volume 3 (1991/1992), 1–22, at 12-13.

⁸³ Richard Brooks, 'The Efficient Performance Hypothesis' (2006). Faculty Scholarship Series. Paper 1698., at 570.

This chapter introduces and examines the efficient breach theory as well as brings forth some other efficiency factors to which scholars have paid attention. This chapter discusses the theory's origins and basic concepts and also the reception and the most prevalent counter-arguments it has sparked.

3.2.1 Efficient Breach as a Counter-argument for Disgorgement

The principle that a wrongdoer should not be allowed to profit from his wrongs might, in general, favor the applicability of disgorgement.⁸⁴ In contrast, the efficient breach theory effectively disregards the ethical perspective of the issue as well as other concerns of promise-keeping at large and, instead, focuses on what would be the best outcome in contract breach situations from the perspective of economic efficiency.

In other words, it determines what kind of allocation of resources and liabilities results in the most proficient cumulating of those resources in the society in general. And the question then becomes whether it is necessary to try and deter contract breaches which ultimately allow the resources needed to perform the contract to be allocated more efficiently, even when taking into account the payable expectancy damages for the aggrieved party. One of the accounts of introducing this idea was formulated in the following manner: *“Repudiation of obligations should be encouraged where the promisor is able to profit from his default after placing his promisee in as good a position as he would have occupied had performance been rendered.”*⁸⁵

It is said that the basis of the theory can be found already in writings of Holmes, as he contended that the duty to keep a contract in common law means the prediction that one must pay damages, but nothing else.⁸⁶ Therefore, one should be free to decline to perform within the precondition that he or she becomes liable to compensate the other party.⁸⁷

⁸⁴ Halifax Bldg. Soc'y v. Thomas, [1995] 4 All E.R. 673 (C.A.) (Eng.), cited in: McCamus (n 25), at 951.

⁸⁵ Robert L. Birmingham, 'Breach of Contract, Damage Measures, and Economic Efficiency', 24 RUTGERS L. REV. (1970) 273, at 284.

⁸⁶ Holmes (n 2), at 462.

⁸⁷ Siems (n 10), at 51.

More recently, this line of reasoning has been supported in the economic analysis of law⁸⁸ presented most prominently by judge *Richard Posner*.⁸⁹ His position was that if a third party is willing to pay enough for a commodity so that the promisor is able to realize a profit after compensating the promisee for her expectation, then the promisor should go ahead and sell the commodity to the third party, while the law should do no more than require the payment of the promisee's expectation interest.⁹⁰

It flows from this dynamic that an efficient breach of contract should in general⁹¹ not only be accepted but even encouraged because of its inherent feature of value-maximization. The counter-argument that the potential contract-breaker should renegotiate its contractual obligations and the release of those obligations is not regarded as persuasive due to the consequent additional transaction costs. Moreover, it has been argued that the aggrieved party remains indifferent as long as it receives full compensation for its loss.⁹² This leads to the breach being 'Pareto superior' since, besides the net economic gain, no one will be left worse off than before as a result of the breach of contract.⁹³

In conclusion, the seller is better off, the second buyer is better off, and the original buyer's loss has been duly compensated, which makes him indifferent about the whole incident. The theory naturally insists that this opportunity for more efficient allocation of resources will be lost if the seller is demanded to renegotiate and purchase a release from the first buyer and, therefore, the seller should be permitted to act unilaterally. Furthermore, a rule that might result in the stripping of the seller's profits would effectively discourage the described-like efficient behavior.⁹⁴

It can be suggested that should the efficient breach theory hold true, it would be a strong argument against any excessive protection of the performance interest in contract law. This is because if disgorgement is available to the aggrieved party and the breaching party

⁸⁸ See Richard A. Posner, 'Values and Consequences: An Introduction to Economic Analysis of Law', University of Chicago Law School, Program in Law and Economics Working Paper 53 (1998), at 2: "*The economic analysis of law, as it now exists not only in the United States but also in Europe, which has its own flourishing law and economics association, has both positive (that is, descriptive) and normative aspects. It tries to explain and predict the behavior of participants in and persons regulated by the law. It also tries to improve law by pointing out respects in which existing or proposed laws have unintended or undesirable consequences, whether on economic efficiency, or the distribution of income and wealth, or other values.*".

⁸⁹ See generally Posner (n 35).

⁹⁰ *Id.*, at 118-26, 130-31.

⁹¹ Even Posner has hinted of exceptions in case of opportunistic breach, Posner (n 35), at 117-126.

⁹² D. Campbell and D. Harris, 'In Defence of Breach: A Critique of Restitution and the Performance Interest', (2002) 22 *Legal Studies* 208 at 219; Temple (n 19), at 93.

⁹³ Siems (n 10), at 51-52.

⁹⁴ McCamus (n 25), at 949-950.

could be required to disgorge the gain from the breach, there is no incentive to strive for the extra profits via efficient breach.⁹⁵ However, it has been opined that the mere fact that breaching an existing contractual obligation can be efficient (i.e. nonperformance might on occasion be more profitable than performance) is still judicially distinct from establishing a rule that renders it optional for the promisor to perform or not and make those gains accordingly.⁹⁶

3.2.2 The Reception and Critique of the Theory

In general, what has most provoked disapproval of the efficient breach theory consists of strong moral sentiments regarding the possible optionality regarding performance and nonperformance of a contract. In simple terms, to not perform where one could, is not a 'right' but is in fact a 'wrong', and thus, promisors should not be able to freely profit from their unilateral decision-making as to whether to comply with a contractual obligation or not.⁹⁷ Clearly, the efficient breach theory's creed runs counter to the long-standing *pacta sunt servanda* principle.

Indeed, the theory has been subject to extensive criticism.⁹⁸ A common critique of the efficient breach theory connects to the uncertainty of the transaction costs being lower when efficient breach is allowed.⁹⁹ The theory suggests that if you allow the promisor to sell to a higher bidder without negotiating with the promisee beforehand about lifting the contractual obligation, it saves unnecessary transaction costs. However, it has been pointed out that it is not realistic to suggest that payment of damages in this scenario would not entail any transaction costs. After all, the costs of litigation from claiming and enforcing a relief of compensatory damages could easily out-weigh transaction costs from bargaining.¹⁰⁰

⁹⁵ Eisenberg (n 62), at 570.

⁹⁶ Brooks (n 83), at 572.

⁹⁷ *Id.*, at 572-573.

⁹⁸ See generally e.g. Daniel Friedmann, 'The efficient breach fallacy', (1989) 18 *Journal of Legal Studies* 1; Burrows (n 12); A S Burrows, 'Remedies for Tort and Breach of Contract', 3d ed. (2004); James Edelman, 'Restitutory damages and disgorgement for breach of contract' (2000) *Restitution Law Review* 129, at 145-148; Ian R. Macneil, 'Efficient Breach of Contract: Circles in the Sky', 68 *VA. L. REV.* 947 (1982); Richard O'Dair, 'Restitutory Damages for Breach of Contract and the Theory of Efficient Breach: Some Reflections', 46 *Current Legal Problems* 113 (1993); Sidney DeLong, 'The Efficiency of a Disgorgement as a Remedy for Breach of Contract', 22 *IND. L. REV.* 737 (1989).

⁹⁹ Efficient breach theory is based on "*the implied assumption [that it] entails no transaction costs. This is, however, totally unrealistic.*", Friedmann (n 98), at 6-7; William S. Dodge, 'The Case for Punitive Damages in Contracts', 48 *Duke L.J.* 629, 634 (1999) ("the transaction costs of negotiating a release are typically lower than the assessment costs of establishing damages at trial").

¹⁰⁰ Siems (n 10), at 52.

Another criticism of the theory is that it is doubtful whether or not its application would generally lead to more efficient use of resources. This uncertainty is based on the concern that this kind of relaxation of contract remedies might have harmful effects on the efficiency of the general contracting system. For example, if the parties could not rely on the promise (i.e. performance), or would fear uncompensated loss, they could end up more skeptical of entering into a contract from the beginning or they might face more pressure to participate in time-consuming, costly and inefficient negotiations about the contract terms.¹⁰¹

Furthermore, the presumed ability of the potential contract-breaker to accurately assess the balance between his gains and the promisee's loss can be questioned. In addition to foreseeing the costs of litigation, the contract-breaker would have to correctly assess the amount of loss the contract breach will cause.¹⁰² This can be seen as a factually flawed premise of the theory.¹⁰³ Moreover, the notion that the aggrieved promisee who would receive expectancy damages instead of the contract subject would be ultimately and subjectively indifferent with this outcome has also invited criticism.¹⁰⁴ This relates to the previous point since both are linked to the promisor's assumed ability to know exactly how the promisee values the contract subject.¹⁰⁵

A simple but profound normative argument against the efficient breach theory has been that economic efficiency cannot be the only principle to adhere to in contract law.¹⁰⁶ It has been further argued that the theory effectively achieves to undermine the institution of contract as well as its promise-keeping function, and that "it strikes at the principle of freedom of contract and the idea of a just society. Given the choice, we would choose a

¹⁰¹ Id.; Eisenberg (n 62), at 573-574. ("In addition, the theory would diminish the efficiency of the contracting system. The efficiency of that system does not rest, as the theory of efficient breach implies, solely on legal remedies. Rather, the efficiency of the system rests on a tripod whose legs are legal remedies, reputational effects, and the internalization of social norms-in particular, the moral norm of promise-keeping. These three legs are mutually supportive. Because all three legs are necessary to support the efficiency of the contracting system, anything that weakens one leg seriously threatens the efficiency of the system. The theory of efficient breach, if widely adopted, would do precisely that because the effect of the theory would be to remove the moral force of promising in a bargain context. The moral meaning of making a promise is to commit yourself to take a given action in the future, even if, when the action is due to be taken, all things considered you no longer wish to take it.")

¹⁰² Siems (n 10), at 52.

¹⁰³ Eisenberg (n 62), at 572.

¹⁰⁴ Roy Ryden Anderson, 'The Compensatory Disgorgement Alternative to Restatement Third's New Remedy for Breach of Contract', Southern Methodist University Law Review, Vol. 68, No. 4, 2015, at 957; Eisenberg (n 62), at 575, 577.

¹⁰⁵ Eisenberg (n 62), at 572.

¹⁰⁶ *Adras Ltd v Harlow & Jones GmbH* (1988) 42(1) PD; (1995) RLR 235 at 241 (S Levin J: "the approach of the economic school of law ignores in cases like this the fact that we are dealing with people with moral feelings and not with robots"), and 272 (Barak J: "the economic approach does not give enough weight to considerations which cannot be measured in economic terms", cited in Siems (n 10), at 52 (fn 138)).

society in which parties are encouraged to perform and not to breach their contractual obligations.”¹⁰⁷

Also, as regards the economic perspective, the significance of trust and, for example, correlation between trust and economic efficiency and economic growth has been established to some extent in economic literature.¹⁰⁸ Surely, enshrining promise-keeping as a value within contract law has at least some positive effects on the system’s overall efficiency in the long run.

An interesting notion about efficient breach and disgorgement is that even if allowed, in an isolated case, disgorgement would not have a direct effect on the phenomenon of ‘efficient breach’ per se. Instead, it would change the distribution of the benefits by way of granting the profit to the aggrieved promisee.¹⁰⁹

It can still be assumed that the availability of disgorgement, through its deterrence-effect, would hinder the likelihood of promisors opting out of binding contractual obligations in hope of accruing more plentiful gains elsewhere if they would eventually be required to offer those gains to the promisee. In this sense, disgorgement would still prevent the supposed efficiency gains attributable to breaching according to the theory.

What has been described as a conventional refutation¹¹⁰ of the said theory is that even if the original contract is upheld and the promisee receives the goods, in all likelihood, the third party who was prepared to pay more is still prepared to pay the same price and, thus, can buy the goods from the promisee.¹¹¹ Therefore, if there would indeed be a party who values certain goods more than the original promisee, the goods will most probably wind up in the hands of the party who values them most. Also in this scenario, a corresponding gain to that of the ‘efficient breach’ would instead flow to the party who had already purchased the goods¹¹² and there would be no litigation costs.

Even Posner seemed to recognize implicitly that gains from a breach are likely to exceed the promisee’s expectation only when the subject of the contract is unique or otherwise

¹⁰⁷ John Rawls, ‘A Theory of Justice’ (1973), at 12, cited in: Siems (n 10), at 52-53 (fn 140), referring to Rawls’ theory of a just society being defined by the choice we would be most likely to make if we would not know what our position in that society would be.

¹⁰⁸ See generally Paul J. Zak and Stephen Knack, TRUST AND GROWTH, *The Economic Journal*, 111 (April), 295-321. Royal Economic Society 2001.

¹⁰⁹ Steve Thel & Peter Siegelman, ‘You Do Have to Keep Your Promises: A Disgorgement Theory of Contract Remedies’, 52 *William & Mary Law Review* 1181 (2011), at 1202. (Although, also in this scenario the uncertainty regarding litigation costs would persist.)

¹¹⁰ *Id.*, at 1203.

¹¹¹ Friedmann (n 98), at 5.

¹¹² Eisenberg (n 62), at 573.

not available in the market.¹¹³ This is because when a widget¹¹⁴ is available in the market, the overbidding third party can get the widget from the market, just as the two original contracting parties can. If the third party buys from the promisor instead of the market, under expectancy damages rule applied in form of contract-market price differentiation, the promisor will effectively be required to surrender his gain from the breach. Furthermore, the widget is available in the market, the costs associated with the purchase-line of promisor – promisee – third party, should be significantly lower than the costs resulting from litigating.¹¹⁵

Indeed, it has been suggested that one situation where the efficient breach theory should be seriously considered is when the contract subject is not available in the market. However, the subsequent notion is that the promisor is not permitted to profit here either because of the availability of specific performance. Thus, even under the system of promisee-based expectancy remedy, efficient breaches are likely to be rare occurrences.¹¹⁶

Additionally, it has been estimated that the tension between efficient breach and disgorgement remedy will unlikely concern courts when they examine the possibility of disgorgement.¹¹⁷ During the existence of the efficient breach theory, it has been described to have been inhabiting almost exclusively the academic literature and law school lecture halls.¹¹⁸ Practicing lawyers and judges, in turn, have been either ignoring or rejecting the theory.¹¹⁹

Turning to the CISG and its presumable attitude towards the efficient breach considerations, it should be noted that under the CISG's strict policies regarding impediment and consequent exemption,¹²⁰ the prevailing interpretation is that even a losing contract must be performed.¹²¹ In this sense, the Convention could be described as siding with the principle of *pacta sunt servanda*. On the other hand, the damages system of the CISG, at least

¹¹³ Posner (n 35), at 118-126, 130-131.

¹¹⁴ The term 'widget' is often used as a neutral and generic noun about something tangible that is, or might be sold, in various illuminating examples of legal literature.

¹¹⁵ Thel & Siegelman (n 109), at 1203-1204.

¹¹⁶ *Id.*, at 1204.

¹¹⁷ Anderson (n 104), at 958.

¹¹⁸ Andrew Kull, 'Disgorgement for Breach, the "Restitution Interest," and the Restatement of Contracts', 79 TEX. L. REV. (2001), at 2051.

¹¹⁹ Craig S. Warhol, 'Resolving the Paradox Between Legal Theory and Legal Fact: The Judicial Rejection of Efficient Breach', 20 CARDOZO L. REV. (1998) 321, at 334-340.

¹²⁰ See Art. 79 CISG.

¹²¹ UNIDROIT Principles 2010, Article 6.2.1: "...even if a party experiences heavy losses instead of the expected profits or the performance has become meaningless for that party the terms of the contract must nevertheless be respected."

in its wording, adheres to the expectation principle where specific performance can be awarded, but is deferred under discretionary rule based on domestic law considerations.¹²²

One of the interpretative principles of the CISG, namely good faith, could be seen as a countering force against the dominant efficiency perspective that the efficient breach theory represents.¹²³ Another related question is: what will be the CISG's position be regarding the object of deterring contract breaches at large? After all, the efficient breach theory is, in some sense, antithetical to the recognition of a need to deter breaches, and, instead, views them as something to be encouraged as long as they add to economic efficiency.¹²⁴ The CISG will be brought into the discussion later on where its damages- and interpretation doctrine will be examined in relation to these themes.

To conclude our discussion of the efficient breach theory, it is necessary to bear in mind as a general rule that even when an opposing argument against a theory could be repudiated, that alone might not indicate much of anything about the validity of the opposed theory itself. There has been a considerable amount of criticism towards accepting disgorgement in contract law that is not based on economic efficiency perspectives, but rather on the need to preserve the cohesion and functionality of contract damages system and on the hazardousness of excessive emphasis on moral condemnation in contract law.

3.3 Corrective Justice and Disgorgement

This chapter is meant to further elaborate and broaden the theoretical framework in which the availability of disgorgement has been evaluated. In particular, it will introduce some of the viewpoints the corrective justice theory, in private law, has produced attempting to explain disgorgement and its possible shortcomings.

Corrective justice is a school of thought that has provided principled viewpoints on our subject and it offers a useful tool for evaluating disgorgement because it does not stem from any specific legal system¹²⁵ but instead examines the deeper structures behind different legal remedies. According to corrective justice, the normative structure of private

¹²² See Art. 28 CISG.

¹²³ Perhaps a bit ironically, both efficient breach and disgorgement, even though pointing in opposite directions when it comes to contract damages, might be subjected to some form of bias due to their somewhat foreign background in legal cultures outside American common law when applying the CISG.

¹²⁴ Temple (n 19), at 94.

¹²⁵ Even though it clearly is culture-specific in terms of its roots in western philosophical tradition.

law entails that remedies achieve their justification by their quality of correcting a wrong perpetrated by a defendant and suffered by a claimant.¹²⁶

The philosophical roots of this theory reach into the ideas of Aristotle himself,¹²⁷ presented in *Nicomachean Ethics*, where Aristotle argued that corrective justice is only concerned with “rectification in transactions” between persons¹²⁸ i.e. that the disturbance of status quo needs to be reinstated.¹²⁹ Thus, corrective justice demands the undoing of an injustice, something which wrongful gains, as well as the harm to the aggrieved party, could be construed as. The theory of corrective justice links the nature of breaching one’s duty and the consequential violation of another’s right inseparably as a phenomenon. The aggrieved party’s loss can be seen as attributable to the wrongdoer’s gain and vice versa.¹³⁰

This bipolarity of the theory also partly explains why different takes on the theory’s proper interpretation in the context of private law have led to it being invoked both for and against the applicability of disgorgement. On one hand, a principled connection between gains acquired through a breach and the injured party’s loss might be a tempting starting point for construing the gains as an indicator of injustice, albeit challenging to prove in practical terms. On the other hand, the opposite can also be argued: that the non-existence of observable loss could serve as an indicator of the absence of injustice demanding rectification.

The remedial aspect of corrective justice has been described in the following manner by *Ernest Weinrib*: “...remedy corrects the injustice suffered by the plaintiff at the defendant’s hand.”¹³¹ Under the corrective justice theory, the connection between a right and a remedy is an intimate one. It views the claimant’s right and the defendant’s correlative

¹²⁶ See Botterell (n 14), at 137-138; Ernest Weinrib, ‘Restitutionary Remedies as Corrective Justice’ (2000) 1 *Theoretical Inquiries in Law* 1-37, at 4.

¹²⁷ Weinrib (n 126), at 37: “Drawing on Aristotle, the theory of corrective justice locates the structure of these norms in the correlativity of doing and suffering. Drawing on Kant and Hegel, the theory locates the normative grounding of private law in the idea of self-determining agency that is contained in the law’s ascriptions of responsibility.”

¹²⁸ Aristotle, *Nicomachean Ethics* (Translation. Irwin trans., Hackett, 1985), cited in: Botterell (n 14), at 137.

¹²⁹ Siems (n 10), at 43.

¹³⁰ Ernest J. Weinrib, *The Gains and Losses of Corrective Justice*, 44 *Duke Law Journal* 277-297 (1994), at 280. (E. J. Weinrib, *The Gains and Losses of Corrective Justice* 1994)

¹³¹ Weinrib (n 50), at 55.

duty as the building blocks of the normative relationship between the parties. As for monetary damages, they are essentially an attempt of private law to rectify the defendant's violation of the claimant's right in terms of money.

In corrective justice, the nature of the right and its counterpart of a duty are said to also determine the nature of the remedy. Along these lines, broader policy considerations that are outside of the parties' relationship should play no role.¹³² It flows from this that compensatory damages fall within the principles of corrective justice as long as they are able to remedy the aggrieved right of the claimant. Disgorgement, in turn, can be seen as questionable, if it has objectives situated outside the claimant's right.¹³³

Corrective justice also entails that the liability of a certain defendant is necessarily a liability to a certain claimant. This is in line with the principled notion that the parties are not to be considered as entirely independent actors in the eyes of the law, but rather as the one who inflicts and the one who receives the same injustice. Thus, the remedy should mirror, as a response, the correlatively structured injustice. A reason for considering the breaching party to have caused injustice should also be the reason to consider that the claimant has suffered injustice. This can also be seen as the logical continuum for the 'right and obligation' dichotomy, which is perhaps more well-known in general.¹³⁴

What corrective justice and disgorgement do have in common is the idea that profiting from a breach of contract is a 'wrong'. The problem with reconciling these concepts is that it is not as self-evident that the gains targeted via disgorgement are something to which the claimant has the better right. Furthermore, it has been argued that for disgorgement to be a corrective justice remedy the claimant should have some normative entitlement to said gains in order for the remedy to rectify a wrong caused by the actions of the defendant.¹³⁵

From the perspective of corrective justice, what makes this issue perhaps a bit less problematic regarding the legitimacy of disgorgement as a contract law remedy is the notion that in some cases of expectation damages, the above-mentioned normative entitlement

¹³² See *id.*, at 61, 103; Weinrib (n 126), at 37: "*Purposes such as punishment or deterrence (or broader purposes such as the promotion of economic efficiency or of other goods), even if they otherwise seem desirable, cannot be accommodated to the correlative nature of private law justifications and therefore cannot explain the most characteristic and pervasive features of private law. Thus, in this context as in others, corrective justice breaks free of the instrumentalist modes of explanation that over the last decades have so brilliantly obscured private law.*"

¹³³ Weinrib (n 50), at 57.

¹³⁴ *Id.*, at 59-60.

¹³⁵ Botterell (n 14), at 141; Weinrib (n 50), at 74-75.

might also be dubious, and thus, disgorgement might not be any more problematic from the perspective of corrective justice than expectation damages are in some circumstances.¹³⁶

Nevertheless, in many cases where disgorgement has been awarded,¹³⁷ it has been done regardless of the fact that there was not a discernable loss on the side of the claimant reflecting the gain of the defendant. This is the issue that makes disgorgement as a remedy ‘puzzling’ from the viewpoint of corrective justice.¹³⁸

One further issue that has also been addressed in corrective justice is the nature of the contractual performance as what is owed due to the contract: is it an action or a particular thing? The conclusions regarding disgorgement’s place within the corrective justice can be viewed as two-fold relating to this question.

First, there is the view that when the promisee has contracted for unique or non-generic goods, he or she can be seen as entitled to the profits obtained by the promisor via selling the contracted-for unique goods to a higher bidder due to a proprietary interest attached to the specific goods.¹³⁹ Weinrib ponders about this perspective:

*“So far as corrective justice is concerned, disgorgement is an appropriate remedy when the defendant wrongfully alienates something to which the plaintiff had a proprietary right. By virtue of ownership the owner is entitled to all the profits that accrue from the alienation of what is owned.”*¹⁴⁰

Because of the conception of contracts as vehicles for making promises to the effect that what one owes under a contract is an action to deliver a widget instead of the widget itself, it is problematic to derive the right to disgorgement by construing a proprietary right into a contract which had only promised an action. In other words, a contract generates only a personal claim to the promising party’s performance and, thus, there is no direct link between contractual entitlement and proprietary right.¹⁴¹

Botterell is of a different opinion and argues from the perspective of corrective justice that “*when an action or performance contracted for is particular, disgorgement will be*

¹³⁶ *Botterell* (n 14), at 141.

¹³⁷ See *British Motor Trade Ass’n v. Gilbert*, [1951] 2 All E.R. 641; *Hickey & Co., Ltd. v. Roches Stores (Dublin) Ltd.*, [1993] H. Ct. (1976) (Ir.); *Adras Bldg. Material v. Harlow & Jones* 42(1) P.D. 221 [1988]; *Attorney General v Blake* [2001] 1 AC 268 (H.L.).

¹³⁸ *Botterell* (n 14), at 142.

¹³⁹ Assuming that specific performance cannot be awarded for one reason or another.

¹⁴⁰ Weinrib (n 50), at 77.

¹⁴¹ *Id.*, at 75, 82-83.

available”.¹⁴² Botterell basically sees a contractual promise including the implicit promise not to breach, and thus “nothing stands in the way of viewing disgorgement damages as a form of compensatory damages.... because disgorgement damages seek to put the...promisee in the position she would have been in had she...received what she was promised and so was entitled to...”¹⁴³

To conclude this subchapter, it can be noted that the corrective justice theory has been interpreted in both ways: as complying with the idea of disgorgement and being inconsistent with it. What could be inferred from the theory is that both sides of these differing views clearly attach some significance to the question of whether the contracted-for goods are unique or generally available at the marketplace. This, in turn, is mostly due to issues of inadequacy of monetary damages and the proprietary interest in a specific object.

¹⁴² Botterell (n 14), at 153.

¹⁴³ Id., at 158.

4. The Restatement (Third) of Restitution and Unjust Enrichment

This chapter will deal with perhaps the articulated acceptance of disgorgement in contract law and the discourse around this specific occurrence. This part of the thesis represents the comparative perspective and intends to introduce recent developments in the U.S. contract law regarding disgorgement for readers primarily interested in the CISG.

4.1 The Restatements of Law: A Brief Overview

Restatements of law are a special part of the doctrinal landscape of the U.S. legal system and they are issued by the American Law Institute (ALI) to help compose the currently applicable legal doctrine of a specific field of law ranging from employment law to the law of international commercial arbitration. The goal of a restatement is, in essence, the clarification and simplification of the U.S. common law, as well as its adaptation to societal changes.¹⁴⁴

The American Law Institute was established in 1923 and the members of ALI are composed of law professors, attorneys, judges and other legal professionals. Courts and legislatures in the U.S. regularly take ALI's restatements as authoritative reference material in different legal issues.¹⁴⁵

ALI's method in addressing the problem of looming dangers to uniformity of law, by the diversity of growing body of a certain field of the U.S. common law, was to produce an unofficial but authoritative summary of the substance of jurisprudence in an area or branch of the law. Subsequently, the institute put forward a plan to write these Restatements of law by appointing 'Reporters', who were typically leading academic experts in a given field of law that was to be restated, as well as advisers from all three branches of the legal profession.¹⁴⁶

The classical structure of a restatement of law is composed of propositions of law, explanatory commentary and a set of enlightening illustrations from the reported case law. The main function of the Restatements was to accurately summarize the existing law, but it was originally accepted as well that the Restatements could "*promote those changes*

¹⁴⁴ "ALI drafts, discusses, revises, and publishes Restatements of the Law, Model Codes, and Principles of Law that are enormously influential in the courts and legislatures, as well as in legal scholarship and education.", at: <https://www.ali.org/about-ali/>.

¹⁴⁵ McCamus (n 29), at 440-441.

¹⁴⁶ John P. Frank, 'The American Law Institute, 1923-1998', Hofstra Law Review: Vol. 26: Issue 3, Article 4. (1998), at 616.

which will tend better to adapt the law to the needs of life” with the caveat that such proposals of modification should be generally accepted as beneficial.¹⁴⁷

In any case, the essential objective of the Restatements was to restate rather than reform the existing law and it has been estimated that this function, in particular, has led to the recognition of the Restatements as authoritative reports of the existing law.¹⁴⁸

Perhaps the most striking feature of the process to create a new restatement of law is that the whole membership of the ALI (consisting of some three thousand lawyers) must approve the tentative draft produced by the reporter:

*“...the black letter will be presented, section by section, to a room of hundreds of lawyers, any one of whom has standing to intervene and raise questions on anything from the substantive rule that is proposed to the choice of words or punctuation in the draft. Not surprisingly, the production of the whole document takes years, but the result is that when it is complete, it has the authority that comes from the successful negotiation of this complex procedure.”*¹⁴⁹

4.2 Restatement (Third) of Restitution and Unjust Enrichment

The final Council Draft of the Restatement Third of Restitution and Unjust Enrichment (R3RUE)¹⁵⁰ was approved on May 12, 2010, and the final edited version of the Restatement was published by ALI a year later. The entire process of creating the R3RUE lasted fifteen years.¹⁵¹

To briefly lay out the appropriate context, the reader should acknowledge the broader substance of the R3RUE. It covers the U.S. legal rules on topics such as payments made by mistake, under duress, via transactions deemed ineffective by different doctrines of common law and also the recovery of benefits obtained through tortious- or another kind

¹⁴⁷ Id., at 617-618.

¹⁴⁸ McCamus (n 29), at 440-441.

¹⁴⁹ Lionel Smith, ‘Book Review of “Restatement (Third) of Restitution and Unjust Enrichment”’, (2012) 57:3, 629-638, McGill Law Journal, at 631-632, see id: “...the restatements are often the easiest way to determine, to the extent such a thing is possible, what the US law is”.

¹⁵⁰ R3RUE.

¹⁵¹ McCamus (n 29), at 444.

of wrongdoing.¹⁵² The R3RUE does not segregate the different remedies or doctrines on the basis of their respective roots being in law or in equity.¹⁵³

The doctrine of the R3RUE is that it describes the law of restitution in general as the law governing circumstances in which a person is deemed liable for received benefits and in which the liability is measured by the extent of the benefit.¹⁵⁴ The first type of restitution consists of the recovery of mistakenly paid money and other instances of unjust enrichment. The second type of restitution of benefits (and the one this thesis is interested in) is where the benefit is not acquired directly from the promisee but from third parties by breach of a certain duty owed to the promisee.

An example of this type of restitutionary obligation is where a fiduciary abuses its duty towards the beneficiary by engaging in profitable dealings with third parties and as a consequence is ordered to disgorge these profits. Disgorgement is necessary in order to prevent the fiduciary's 'unjust enrichment' under the R3RUE.¹⁵⁵

Restitution claims in general (including those for disgorgement) share the central function of preventing "*the defendant's unjust enrichment by recapturing the gains the defendant secured in a transaction.*"¹⁵⁶ Thus, restitution measures the defendant's gain after which it requires him or her to disgorge a sum equal to the gains which can be traced back to the transaction or wrongdoing in question.¹⁵⁷

Undoubtedly, the most groundbreaking clarification of the applicable restitution doctrine in the new Restatement is the limited, but explicit, approval of disgorgement for breach of contract.¹⁵⁸ It is necessary to note that the reporter of the R3RUE himself estimated that these cases would be rare.¹⁵⁹ The rule laid out in § 39 R3RUE, which stipulates disgorgement as applicable in some cases of breach of contract, has been described as "daring"

¹⁵² Id., at 444.

¹⁵³ See R3RUE, § 4(1) ("*Liabilities and remedies within the law of restitution and unjust enrichment may have originated in law, in equity, or in a combination of the two.*"). However, disgorgement has been suggested to originate from the realm of equity, see also Steven W. Feldman, 'Rescission, Restitution, and the Principle of Fair Redress: A Response to Professors Brooks and Stremitzer', 47 Val. U. L. Rev. 1 (2013), at 464.

¹⁵⁴ R3RUE, § 1 cmt d.

¹⁵⁵ Feldman (n 153), at 444-445.

¹⁵⁶ Restatement (First) of Restitution § 1 (1937), cited in: Dobbs (n 54), at 551-552.

¹⁵⁷ See id., at 555-556.

¹⁵⁸ R3RUE, § 39.

¹⁵⁹ Id. § 39 cmt. a.

but also as “one of the Restatement’s major contributions to and clarifications of the law”.¹⁶⁰

On the part of disgorgement for breach of contract, as has been touched upon above, it is not always obvious from the surface whether the situation is of the kind that the benefit has been obtained *at the expense of another* in circumstances where the claimant itself could not have obtained the benefit in question. The R3RUE provides the following clarification on this matter:

*“While the paradigm case of unjust enrichment is one in which the benefit on one side of the transaction corresponds to an observable loss on the other, the consecrated formula ‘at the expense of another’ can also mean ‘in violation of the other’s legally protected rights,’ without the need to show that the claimant has suffered a loss.”*¹⁶¹

The R3RUE also states the general principle underlying disgorgement in the following manner: “A person is not permitted to profit by his own wrong.”¹⁶² This principle, that people should not be allowed to profit by wrongdoing and its significance is affirmed in other parts of the Restatement as well.¹⁶³

Rather boldly, the R3RUE does not shy away from stating its stance in clear terms on the fundamental issue of disgorgement’s contradictory nature in relation to the full compensation principle¹⁶⁴ as it advocates that the doctrine of restitution should permit a claimant’s recovery of “more than a provable loss so that the defendant may be stripped of a wrongful gain.”¹⁶⁵ It also clarifies that in allowing disgorgement the deterrence effect is sought after as well.¹⁶⁶ Disgorgement’s function of deterring opportunistic breaches is also recognized elsewhere.¹⁶⁷

¹⁶⁰ Smith (n 149), at 633 and Michael Traynor, ‘The Restatement (Third) of Restitution & Unjust Enrichment: Some Introductory Suggestions’, Washington and Lee Law Review (2011) Vol. 68, 899-910, at 902.

¹⁶¹ R3RUE, at 3.

¹⁶² Id. § 3.

¹⁶³ Id. §§ 40-44.

¹⁶⁴ James S. Rogers. ‘Restitution for Wrongs and the Restatement (Third) of the Law of Restitution.’ Wake Forest Law Review 42, (2007): 55-91, at 66: “On balance, the law is better if it is openly acknowledged that in some extreme cases a person ought not be able to profit from breach of contract, even if that notion is in tension with much of what underlies contract law.”.

¹⁶⁵ R3RUE, § 3 cmt. a.

¹⁶⁶ Id. § 3 cmt. c, “Restitution requires full disgorgement of profit by a conscious wrongdoer ... because any lesser liability would provide an inadequate incentive to lawful behavior.”.

¹⁶⁷ See Caprice L. Roberts, Restitutionary Disgorgement as a Moral Compass for Breach of Contract, 77 U. CIN. L. REV. 991, 995 (2009); see also Snapp, 444 U.S. at 515 (stating that disgorgement is a reliable deterrent to breach).

To the extent to which disgorgement would manifest in overcompensation for the claimant, it is still not regarded as punitive, at least within the confines of the common law terminology.¹⁶⁸ This is because even if disgorgement would constitute more than compensation to the claimant, it would not be more than what the defendant gained and therefore would not be punitive in nature.¹⁶⁹

One commentator sees the party claiming for disgorgement as “*society’s representative, similar to a private attorney general, to deprive the promisor of his ill-gotten gain and to uphold the legal and moral objective that promises are meant to be kept and not broken.*”¹⁷⁰ Indeed, the principle that promises must be kept can be waved as an argument in favor of disgorgement as the remedy is said to give “*teeth to the long-standing case law principle*” of *pacta sunt servanda* (i.e. that promises are to be kept).¹⁷¹

It is worth noting that the R3RUE, by way of citing existing case law and subsuming that into a carefully crafted rule, is suggesting that disgorgement can and should be granted by the courts on the basis of the law as it is today.¹⁷² Also, in the doctrine of the R3RUE, instead of a claim of unjust enrichment the claim for disgorgement is rather a contractual claim for a special measure of damages; a claim for restitution arising from a contract rather than avoidance.¹⁷³

4.3 Disgorgement as Prescribed in the R3RUE

The black letter text of the R3RUE, which provides the rule for disgorgement in breach of contract cases is situated under the chapter “Restitution and Contract” and further therein under the topic “Alternative Remedies for Breach of an Enforceable Contract”. The specific provision (§ 39) is titled as (and in its entirety):

Profit From Opportunistic Breach.

(1) If a deliberate breach of contract results in profit to the defaulting promisor and the available damage remedy affords inadequate protection to the promisee’s contractual entitlement, the promisee has a claim to restitution of the profit realized by

¹⁶⁸ R3RUE, § 51 cmt. k (“*Disgorgement of wrongful gain is not a punitive remedy.*”).

¹⁶⁹ Dobbs (n 54), at 567; Robert Cooter & Thomas Ulen, ‘Law and Economics’ (3d ed. 2000), at 234, cited in: Eisenberg (n 62), at 561 (fn 3): (“‘[P]erfect disgorgement’ is ‘a sanction that restores the wrongdoer to the same position that she would have been in but for the wrong’ and thus ‘strips the agent of her gain from misappropriation and leaves her no better or worse than if she had done no wrong.’”).

¹⁷⁰ Feldman (n 153), at 466.

¹⁷¹ Weinrib (n 50), at 73.

¹⁷² Lionel Smith, Legal Epistemology in the Restatement (Third) of Restitution and Unjust Enrichment, Boston University Law Review [Vol. 92:899 2012], at 901-902.

¹⁷³ R3RUE, §37 (introductory note), § 38 cmt a.

the promisor as a result of the breach. Restitution by the rule of this section is an alternative to a remedy in damages.

(2) A case in which damages afford inadequate protection to the promisee's contractual entitlement is ordinarily one in which damages will not permit the promisee to acquire a full equivalent to the promised performance in a substitute transaction.

(3) Breach of contract is profitable when it results in gains to the defendant (net of potential liability in damages) greater than the defendant would have realized from performance of the contract. Profits from breach include saved expenditure and consequential gains that the defendant would not have realized but for the breach, as measured by the rules that apply in other cases of disgorgement (§ 51(5)).¹⁷⁴

We can see that § 39 R3RUE sets out three subsections of which the first (1) lays out the basic function of the remedy, the second (2) elaborates when ordinary damages are deemed *inadequate* and the third (3) explains when a breach of contract actually is *profitable*.

The explanatory comments provided in the R3RUE state that the remedy should be reserved for ‘exceptional cases’, where a profitable breach can be seen as a source of unjust enrichment at the expense of the other party.¹⁷⁵ It goes on to say that the U.S law of restitution, as it currently stands and should be interpreted, “*treats such cases in the same way that it treats other instances of intentional and profitable interference with another person’s legally protected interests*” by providing an alternative remedy for breach.¹⁷⁶

The comments explaining § 39 of R3RUE also tackle the issue of possible overcompensation as a result of disgorgement. It is admitted that a remedy that exceeds the claimant’s provable losses is anomalous when judged by the usual presumptions of contract law because irrespective of the contract-breakers’ motivations, a breach of contract is not generally regarded as a wrong comparable to a tort or breach of fiduciary duty. The Reporter makes the case that while contractual entitlements may often be relatively easy to value, they too would be vulnerable to risks of under-enforcement if the sole remedy for a breach would be a claim for monetary damages.¹⁷⁷

Therefore, when damages provide inadequate protection, courts can guarantee the protection of the injured party by ordering an injunction or specific performance. In essence,

¹⁷⁴ R3RUE, § 39.

¹⁷⁵ Id., § 39 cmt. a.

¹⁷⁶ Id.

¹⁷⁷ Id.

the R3RUE's argument is that restitution in form of disgorgement can provide comparable 'after the fact' protection by awarding the gains from a profitable breach of contract, which the defendant can no longer be made to perform.¹⁷⁸

The concept of 'opportunistic breach' refers to situations where a promisor recognizes that the promisee's position is vulnerable to abuse and attempts to profit from this. One example is that the promisor realizes that the promisee would face difficulties trying to recover a full equivalent of the performance through compensatory damages. *It is said that the mere possibility of allowing this scenario to unfold without a response would undermine the stability of contractual exchange where one party's performance is hard to compel or to value.* The label 'opportunistic' explains why the breach is condemned, but there is no requirement that the claimant proves the motivation of the breaching party.¹⁷⁹

The rule of § 39 is meant to reinforce the position of the 'vulnerable' party and to condemn conscious attempts to take advantage of the situation. It also extends an analogous protection to certain contract rights that are guaranteed when proprietary interests are involved. This is explained by stating that the vulnerable positions mentioned are those in which the promisee would usually be protected by specific performance, or in which parties would often prepare by agreeing upon liquidated damages or specific enforceability. Disgorgement, in § 39, serves the same function of reinforcing a contract, but only at a different stage of the contractual relationship.¹⁸⁰

Another prerequisite for disgorgement pursuant to § 39 is the inadequacy of compensatory damages for protecting the promisee's contractual entitlement. This means that if the contractual entitlement of the promisee is adequately compensated by an award of damages, there is no claim for disgorgement as "*there is no remedial vulnerability to be exploited, no opportunism, and no unjust enrichment*". According to the R3RUE, the adequacy of damages is to be determined by the court applying the governing law to its own understanding through case by case analysis. However, § 39(2) provides the baseline standard for this estimation.¹⁸¹

The R3RUE suggests that one way to examine the adequacy component in potential disgorgement cases is to perform a hypothetical test for the availability of specific relief. If,

¹⁷⁸ Id.

¹⁷⁹ Id. cmt. b.

¹⁸⁰ Id.

¹⁸¹ Id. cmt. c.

in hindsight, there would have been grounds for granting an injunction or specific performance, restitution in the form of disgorgement could be appropriate after the fact. Disgorgement, in this sense, could bring about a remedial equivalent by putting the breaching party to the position the legitimately enforced adherence to contractual performance would have produced.¹⁸²

However, the R3RUE particularizes that even though the parallels between specific performance and disgorgement can be helpful in this examination, use of the parallels cannot serve as a decisive test. In fact, disgorgement would be appropriate in many cases where specific performance would not have been granted because specific performance can be denied for reasons that do not relate to adequacy considerations such as impracticability, difficulties in enforcing the award and/or reasonability perspectives.¹⁸³

The explanatory comments further clarify that also in contexts other than where specific reliefs would have been available, disgorgement could be justified. The following example is given:

“[A] promise not to disclose or utilize confidential information is the usual form by which trade secrets are protected; allowing restitution for breach of the contract is equivalent to restitution for misappropriation of the trade secret. Again, if one party's contractual obligation to another has a fiduciary or confidential character, disgorgement for breach of the contract might be justified by observing that it resembles a liability to account for profits derived from a breach of fiduciary duty.”¹⁸⁴

The comments take a clear-cut stance on the issue whether disgorgement is punitive: as it is stated that while the rule intends to make breach unprofitable, it does not seek to punish the breaching party as it, for instance, does not require the forfeiture of defendant's entire profit from the transaction made in violation of the claimant's rights.¹⁸⁵

The Reporter is also straightforward about disgorgement being the least frequently applied of the available remedies for breach of contract. This is apparently so because the

¹⁸² Id.

¹⁸³ Id.

¹⁸⁴ Id. cmt. d.

¹⁸⁵ Id. cmt. e. Instead, the said profit could be proportioned on the basis of, to what extent, part of the profit can be seen as flowing from specific and separate merit of the defendant.

cumulative requirements set out in § 39 typically exclude a great majority of cases involving a breach of contract.

Firstly, the requirement of the breach being profitable eliminates most breaches from the consideration.¹⁸⁶ Secondly, the requirement that the breach was made deliberately rules out cases of negligence and unsuccessful attempts to perform, which restricts the scope of disgorgement under § 39.¹⁸⁷ Thirdly, even if the breach would be deemed profitable and deliberate as a product of conscious choice, there is no claim under § 39 as long as compensatory damages would ensure adequate protection to claimant's contractual entitlement.¹⁸⁸

4.4 Reception in Legal Literature

The R3RUE is described as an impressive doctrinal presentation of the law of restitution as a whole, and it has received praise from scholars as a comprehensive and influential compaction of this particular field of law.¹⁸⁹ Furthermore, it is predicted to shape the broader understanding of restitution even beyond the U.S.¹⁹⁰ The R3RUE is seen as being situated in an interpretative tradition of not only the common law, but also the civil law.¹⁹¹ Notably, the substantive approach of § 39 has specifically been well-received.¹⁹²

It has been pointed out that, even though § 39 has been presented with words of limitation, the rationale underlying the rule is quite broad and therefore notwithstanding the narrow construction of the rule, it has been implied that its *"implications may be sweeping"*. The same broad rationale is suspected to make disgorgement's proposed function of reinforcing contracts a difficult task.¹⁹³

The major argument of the R3RUE is that disgorgement has a legitimate place within the existing remedial framework of the U.S. contract law. This view of disgorgement is

¹⁸⁶ Id. cmt. f, (*"The basic calculation of compensatory damages makes it highly unlikely, in any transaction for which there are market-based substitutes, that the gain to the defendant as a result of default will exceed the injury to the plaintiff from the same cause. The defendant's potential liability for incidental and consequential damages, over and above the cost of a substitute performance, limits the occurrence of profitable breaches almost to the vanishing point"*).

¹⁸⁷ Id. This limitation is described as *"consistent with the general principle that the disgorgement remedies in restitution are principally addressed to instances of conscious wrongdoing"*.

¹⁸⁸ Id.

¹⁸⁹ Douglas Laycock, 'Restoring the Restitution to the Canon', Michigan Law Review [Vol. 110:929] (2012), at 929.

¹⁹⁰ Smith (n 149), at 629; Smith (n 172), at 899.

¹⁹¹ Id., at 900.

¹⁹² Andrew Kull, 'Discussion of Restatement of the Law Third, Restitution and Unjust Enrichment', 82 A.L.I. PROC. 249, (2006), at 256-259, 262, 266.

¹⁹³ Roberts (n 17), at 142, 148.

largely accepted among commentators¹⁹⁴ and indeed, the U.S courts have applied the remedy in various cases.¹⁹⁵

4.5 Critique Towards § 39 R3RUE

This subsection will summarize some critical points directed towards the disgorgement rule of the R3RUE. Perhaps the most thorough critique has been put forward by *David Campbell* in the article: *A Relational Critique of the Third Restatement of Restitution § 39*. The content provided therein is sufficiently comprehensive for the purpose of this section.¹⁹⁶

The essential dispute between those who welcome disgorgement as a viable - although limitedly deployed - remedy and those who reject it, is whether a breach of contract should be regarded as a ‘wrong’ in and of itself. The criticism of compensatory damages is, in the end, that damages are unable to prevent immoral or amoral contracting behavior of schematic importance and consequently demands disgorgement as an alternative in cases of ‘opportunistic breach’.¹⁹⁷

Campbell, however, claims that expectation-based remedies sufficiently accommodate moral positions by way of encouraging cooperation to deal with the consequences of the breach compared to the wider availability of restitutionary damages which would render “*unbalanced and indefensible power to the plaintiff to vindicate his formal rights*”. He argues that because this recent development in contract law conflicts with the freedom of contract in such a way that it cannot be established without endangering that freedom, the disgorgement of the R3RUE “*has no chance whatsoever of becoming settled law*”.¹⁹⁸

¹⁹⁴ Eisenberg (n 62), at 559-562; Thel & Siegelman (n 109), at 1181; Ronald Israel & Brian O’Neill, Disgorgement as a viable theory of restitution damages, in: Commercial Damages Reporter, Issue January (2014), 3-9; Edelmann (n 13), at 189.

¹⁹⁵ See *Earth Info, Inc. v. Hydrosphere Resource Consultants, Inc.*, 900 P.2d 113 (Colo. 1995); *Dastgheib v. Genentech, Inc.*, 438 F. Supp. 2d 546, 552 (E.D. Pa. 2006); *Univ. of Colo. Found., Inc. v. Am. Cyanamid Co.*, 153 F. Supp. 2d 1231, 1233 (D. Colo. 2001); *Foss v. Heineman*, 128 N.W. 881, 885 (Wis. 1910) (breach of contract context); *Snepp v. United States*, 444 U.S. 507, 507–08 (1980). *The legitimacy of disgorgement is recognized by way of courts generally using the promisor’s profits as the measure of award when those profits tend to define the plaintiff’s losses: Vibra-Tech Eng’rs., Inc. v. Kavalek*, 849 F. Supp. 2d 462, 496–98 (D.N.J. 2012) (disgorging all profits, even if exceeding plaintiffs’ loss because defendants “*should not be allowed to keep the difference, which was gained by their unlawful conduct. If the [defendants] were allowed to keep the difference, this would essentially allow them to benefit simply because they were able to obtain a better profit margin.*”); *Cross v. Berg Lumber Co.*, 7 P.3d 922, 935 (Wyo. 2000).

¹⁹⁶ See Campbell (n 17).

¹⁹⁷ *Id.*, at 1063-1064.

¹⁹⁸ *Id.*, at 1067.

Campbell also criticizes the R3RUE's somewhat categorical rejection of efficient breaches by referring to both courts' reasoning in the Blake case, which intended to restrict disgorgement to not to be used in preventing efficient breach¹⁹⁹ (similarly in an arbitral award).²⁰⁰ He makes the case that should disgorgement be available as an alternative to expectation damages for every breach, contract law would be transformed in an "*utterly chaotic manner*".²⁰¹

In Campbell's representation, the system of contract remedies must balance two competing goals: 1) securing the injured party's benefit of the bargain, but 2) without imposing unnecessary costs on the breaching party.²⁰² To put it briefly, compensatory damages are based on combining the principle of expectation (interest) damages and achieving that without undue burden on the defendant. According to Campbell, the existing balance would face ever-growing instability were disgorgement to be established as a contractual remedy.²⁰³

In summary, in Campbell's eyes the root problem of the current somewhat confused state of contractual remedies in the form of the dissatisfaction for expectancy damages is the "*excessively literal belief in pacta sunt servanda*". Ultimately, contracting parties need to understand what they are doing when contracting, and this, in turn, would require them to abandon their literal belief in *pacta sunt servanda*.²⁰⁴

Roy Anderson is of the view that the support in case law for the new rule of § 39 is not as clear as some suggest it to be, and he locates the true problem in contract remedies' omission of compensating non-pecuniary losses. For Anderson, "*An apportionment of profits is the appropriate remedy, up to full disgorgement in extreme cases.*". He calls for a

¹⁹⁹ Id., at 1072, fn. 33: "See Attorney Gen. v. Blake, [1998] Ch. 439 (C.A.) 459 ("[I]t appears to us that the general rule that damages for breach of contract are compensatory can safely be maintained without denying the availability of restitutionary damages in exceptional cases."); Attorney General v. Blake, [2001] 1 A.C. 268 (H.L.), at 286 (clarifying in which situations disgorgement would not be appropriate). The court stated: [*The lower court*] suggested three facts which should not be a sufficient ground for departing from the normal basis on which damages are awarded: the fact that the breach was cynical and deliberate; the fact that the breach enabled the defendant to enter into a more profitable contract elsewhere; and the fact that by entering into a new and more profitable contract the defendant put it out of his power to perform his contract with the plaintiff. I agree that none of these facts would be, by itself, a good reason for ordering an account of profits."

²⁰⁰ Campbell (n 17), at 1073, fn. 36: See AB Corp. v. CD Co. (The Sine Nomine), [2002], (the Tribunal applied English law and stated that in an exceptional case a plaintiff may "obtain wrongful profits as damages for breach of contract," but that on the facts in this case, an efficient breach did not require disgorgement.)

²⁰¹ Campbell (n 17), at 1074.

²⁰² Eric G. Andersen, Good Faith in the Enforcement of Contracts, 73 IOWA L. REV. 299, 306 (1988), cited in: Campbell (n 17), at 1097 (fn 145).

²⁰³ Id.

²⁰⁴ Id., at 1126.

wider, compensation-based approach, instead of “*the punishment-based, full disgorgement remedy that is proffered by the new Restatement of Restitution*”.

According to Anderson, when a breach has caused an obvious loss by infringing a contractual entitlement or by depriving it altogether, courts typically have no pecuniary index to value the promisee’s loss but when the promisor directly profits from his violation that profit provides the needed pecuniary index with which to measure the loss much like courts have long done for infringements of intellectual property.²⁰⁵

4.6 Summary of the R3RUE’s Disgorgement and Its Context

To summarize this chapter, the requirements for disgorgement as prescribed in the R3RUE are as follows: that the profitable contract breach must be deliberate in that it represents opportunistic behavior, and that expectancy damages fail to provide adequate protection for the bargained contractual entitlement of the promisee.

For the purposes of this thesis and to highlight the underpinnings of R3RUE’s disgorgement, the key principles behind the growing approval of the viewpoint of the R3RUE’s rule should be noted. I would argue that these are: the fundamental need to uphold the principles related to promise-keeping, and that one should not be allowed to benefit from one’s wrong, not even in a contractual context.

As we have witnessed, some argue that this approach is necessary, as it is resolute in substituting the unsatisfactory half-measure that prioritizes the appeasement of the functioning of the broader system of contract damages with an uncompromising full-measure that ensures justice in unusual cases. Their perspective appears to be that should contract law fail to address certain cardinal cases, this could undermine the core-values of the broader system. Others, in turn, contend that the remedy of disgorgement is too uncompromising and that its proponents simply represent a too literal understanding of the *pacta sunt servanda* principle.

However, as the principles in question are, to a great extent, universal, we are able to proceed to the CISG -discussion of this thesis. We will examine how some of the related issues, especially the good faith principle, have been evaluated under the CISG and whether there exists a possibility of arriving at similar conclusions, which have been reached in the U.S. and, to some extent, elsewhere as well.

²⁰⁵ Anderson (n 104), at 1017-1019.

5. Relevant Remedial Provisions of the CISG

For the purposes of this thesis, it is necessary to introduce the basic damages doctrine of the CISG. Also, the material provision stipulating restitution (Art. 84 CISG) will be discussed. Due to the emphasis placed on the part of the analysis concerning the underlying principles of the Convention, this chapter will be largely limited to presenting the provisional framework within which this issue will necessarily play out.

5.1 Article 74 CISG – the General Damages Provision

The right to claim damages for buyer and seller is stipulated in Art. 45(1) b and Art. 61(1) b respectively. Both provisions are based on strict liability as they do not require any fault of the breaching party. The CISG also allows the parties to claim specific performance and gives the right to treat the contract as avoided and subsequently claim restitution. Art. 74 is the provision governing the scope of damages for breach of contract under the CISG. It reads as follows:

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.

The Secretariat Commentary on Art. 74²⁰⁶ states that the article lays out the rule concerning damages by outlining the basic rule for the calculation of damages, and that the following articles (Arts. 75-76 CISG) implement this basic rule by "providing the means of calculating damages in certain defined cases when the contract has been avoided".²⁰⁷ In practice, Art. 74 is the provision that applies in cases where the contract has not been avoided or where there is still losses left uncompensated, even after the application of Art. 75 or 76.

²⁰⁶ Secretariat Commentary on the 1978 Draft, (which is "perhaps the most authoritative source one can cite.", as it is "the closest counterpart to an Official Commentary on the CISG.") (Draft counterpart: Art. 70).

²⁰⁷ Id., at para 1.

The Secretariat Commentary's language is clear in that it explains the execution of the expectation principle as the primary function of Art. 74 CISG.²⁰⁸ The underlining principle contained in Art. 74 is the full compensation principle.²⁰⁹ The full compensation principle is conventionally seen also entailing the rule that the injured party must not be over-compensated as a result of the awarded damages.²¹⁰

As Art. 74 is the general damages provision in the sense that it is intended to cover all the various situations, it does not lay out specific rules describing the method of determining the "loss suffered as a consequence of the breach". Instead, courts and arbitral tribunals must decide what the most suitable method is for the calculation of loss in each case.²¹¹

This speaks for a liberal interpretation of the provision's functionality. In essence, no calculation should be prima facie excluded, as long as it fits within the overall objective to place the injured party in the position that it would have been in without the breach.²¹²

The second part of Art. 74 makes an important limitation to the right to claim damages through the foreseeability requirement. The principle of limiting the recoverable loss to the extent to which the loss was reasonably foreseeable to the breaching party can be found in most legal systems.²¹³ Essentially, the rule serves to exclude causalities that are too remote from the scope of recoverable damages.

Another limiting requirement for recovering damages under the CISG comes from Art. 77, which sets a duty to mitigate loss upon the injured party.²¹⁴ The provision stipulates

²⁰⁸ Id., at para 3, "Article 70 [draft counterpart of CISG article 74] provides that the injured party may recover as damages "a sum equal to the loss, including loss of profit, suffered ... as a consequence of the breach." This makes it clear that the basic philosophy of the action for damages is to place the injured party in the same economic position he would have been in if the contract had been performed. The specific reference to loss of profit is necessary because in some legal systems the concept of "loss" standing alone does not include loss of profit.", the commentary then refers to Farnsworth's statement that "relief to the promisee is to be measured by his expectation, that is, by 'the benefit of the bargain,' and is not limited to the extent of his reliance losses. Although this is nowhere stated in so many words, it seems implicit in a reference to the promisee's 'loss, including loss of profit' in the first sentence of art 70"; The word 'loss' alone might be read narrowly to refer to out-of-pocket reliance expenditures, but the mention of 'loss of profit' makes it clear that is this not what is intended. ...", E. Allan Farnsworth, "Damages and Specific Relief," 27 Am. J. Comp. L. 249 (1979).

²⁰⁹ Ingeborg Schwenzer 'Art 74' in Ingeborg Schwenzer (ed) Commentary on the UN Convention on the International Sales of Goods (CISG) (3rd ed, Oxford 2010), at 1000-1001; CISG Advisory Council Opinion No. 6: 'Calculation of Damages under CISG Article 74', at 1.

²¹⁰ Id., at 9.

²¹¹ Id., at comment 3.12.

²¹² Saidov (n 7), at 172.

²¹³ Djakhongir Saidov, 'Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods', December 2001, Pace Law Web Article, at Chapter II.2.

²¹⁴ Art. 77 CISG.

that the injured party must take action to minimize the losses caused by a breach. The injured party is precluded from remaining indifferent and idle in the aftermath of a breach while expecting the breaching party to pay damages for all losses that accrue. This duty has been described as “perhaps the most important qualification on an injured party’s recovery of damages”.²¹⁵

To return to Art. 74, while its reflectiveness of the expectation principle is acknowledged, the provision’s lack of detail leaves gaps inviting further interpretation.²¹⁶ The CISG Advisory Council Opinion No. 6 has made several clarifications in this regard. An important question is the burden of proof, which is placed on the injured party, who has to prove with reasonable certainty that it has suffered loss and the extent of that loss, although not with ‘mathematical precision’.²¹⁷ This leeway is much required in cases in which the breaching party should not be able to escape liability simply because of difficulties in providing unquestionable proof of the loss. Instead, reasonable certainty is required.²¹⁸

According to Advisory Council’s Opinion No. 6, Art. 74 does not allow the awarding of punitive damages simply because the wording of the article prescribes the sum of damages to be equal to the loss. However, the said Opinion also attaches the motivation to punish onto its qualification of punitive damages.²¹⁹

5.2 Ambiguities in the Interpretation of Article 74

Although, the wording of Art. 74, its rootedness in the expectation principle, natural limitations of the full compensation principle, and the orthodox viewpoint all tend to restrict the interpretation of CISG’s damages rule to the effect of excluding disgorgement of profits from the Convention’s legal praxis, there are viewpoints suggesting that the prevailing interpretation is not as settled as one might think. There are different emphases on different principles of the CISG that render this subject worthy of deeper examination. This

²¹⁵ Joseph F. Morrissey, Jack M. Graves, *International Sales Law and Arbitration*, Kluwer Law International (2008), at 286.

²¹⁶ *Id.*, at 268.

²¹⁷ CISG Advisory Council Opinion No. 6, at 2.

²¹⁸ *Id.*, at comment 3.13.

²¹⁹ *Id.*, at 9 B, 9.5, “*The Convention does not provide for the payment of punitive damages. Punitive damages, also called exemplary damages, are sums awarded in excess of any compensatory or nominal damages in order to punish a party for outrageous misconduct.*”. See also Fritz Enderlein & Dietrich Maskow, ‘*International Sales Law*’, Oceana Publications, 1992, at 299; Peter Huber & Alastair Mullis, *The CISG: A new textbook for students and practitioners*, European Law Publishers, 2007, at 268; Schwenger (n 209), at 1002.

subchapter intends to summarize some of these points in order to provide a complete perspective on the interpretation of Art. 74.

Ingeborg Schwenzer, while stating that an actual claim for disgorgement cannot be drawn from Art. 74, is of the opinion that “*benefits which the promisor obtains from his breach of contract may be taken into account when calculating and assessing damages.*” and that “*the notion that the promisee must not be overcompensated cannot strictly be applied in the context of the Convention either*”.²²⁰

Schwenzer also recognizes the pull for accepting disgorgement of profits in domestic legal systems.²²¹ On the issue of the closely related question regarding the ‘paramount’ performance principle’s growing affirmation in domestic legal systems²²², she states:

*“[T]his changed perception in domestic legal systems needs to be reflected when interpreting the Convention. Such developments must be taken into account in order to prevent courts from feeling the need to apply domestic law in addition to the Convention. This would undermine unification in a core area.”*²²³

Furthermore, Schwenzer asserts that the performance principle’s impact on the interpretation of the CISG is that “*the general idea that a breach of contract must not pay also has to be upheld under the Convention*”.²²⁴

Finally, in her analysis of disgorgement under the CISG, Schwenzer makes the case that “*targeting the profits of the promisor is possible and necessary*”, for example in a situation where “*the seller sells the goods a second time and realizes a higher profit than agreed to under the contract with the first buyer*”.²²⁵

²²⁰ Schwenzer (n 209), at 1002. Interestingly, while evaluating this question Schwenzer also states that “*penal elements can also play a role despite the fact that the Convention does not allow awarding punitive damages*”. However, she still acknowledges that the view that Article 74 CISG does not allow disgorgement of profits is the “*currently general agreement amongst German authors*”, id., at 1017.

²²¹ Id., at 1017.

²²² Id., at 1001, “*As in domestic legal systems, the claim for damages is primarily directed at compensation. Additionally, however, today there is an increasing emphasis on the preventive role of damages. This is accompanied by a shift of focus in regard to contract damages from purely mathematical economic benefits to the interest of the promisee in performance as required by the contract (‘performance principle’).*”

²²³ Id., at 1001.

²²⁴ Id., at 1017. However, Schwenzer adds that “*there are likely to be few cases in the international sale of goods in which the promisee has suffered no loss whatsoever while the promisor was able to make a profit.*”

²²⁵ Id. (The other circumstances where disgorgement might be appropriate according to Schwenzer are where “*the seller, who is contractually obliged to manufacture the goods under humane and environmentally friendly conditions, lowers his production costs by resorting to production mechanisms which are in breach of the agreement, thereby increasing his profit*” and where “*Against an express stipulation in the contract the buyer supplies the European market with the goods purchased and makes according profits*”.)

Leaving little doubt of her, albeit limited, acceptance of disgorgement's potential applicability under the CISG in certain circumstances, Schwenger states that "*the performance principle demands that the profits the promisor has obtained as a result of his breach of contract be disgorged.*". This statement is softened by the assertion that the suggested limited deployment of disgorgement remedy could be also viewed as a calculation method for the damages in cases where damages would be otherwise difficult or even impossible to prove.²²⁶

It is fair to say that Schwenger leaves the reader slightly puzzled. She seems to emphasize perspectives that are not generally recognized as significant as Schwenger depicts them to be. Although Schwenger is regarded as one of the leading scholars on the CISG, it would be ill-advised and also naïve to instantly assume that this appreciation should automatically extend to the particular views referenced above.

However, it should not be overlooked that one specific argument Schwenger presents deals with the comparative perspective, as the recent developments in domestic legal systems is highlighted as a crucial issue. The concern is that the CISG might eventually become irrelevant if it is unable to adapt to significant changes in domestic legal systems.

In any case, I would contend that the development of value-based arguments flowing from an undercurrent of different legal principles²²⁷ is conceivable to anyone who is curious enough to adopt a more schematic perspective and notice the apparent polarity of certain relevant contract law principles.

5.3 Article 84 as a Possible Basis for Granting Disgorgement

Although Art. 74 has gathered most of the attention from authors contemplating disgorgement under the CISG,²²⁸ another option in the form of Art. 84 has been suggested to allow disgorgement of profits for example to a buyer who has fallen 'victim' to a seller's non-performance by way of selling the goods to a higher bidder.²²⁹

²²⁶ Id. See also Djokhongir Saidov & Ralph Cunnington, Current Themes in the Law of Contract Damages: Introductory Remarks, in *Contract Damages: Domestic and International Perspectives*, Hart Publishing (May 2008), at 25-27.

²²⁷ Which, arguably, are observable in the debate about the significance of good faith.

²²⁸ See Schmidt-Ahrendts (n 20), at 90. *Schmidt-Ahrendts is of the view that the only possible option for applying disgorgement is Art. 74.* Cf. Robert A. Hillman (n 229).

²²⁹ See generally Robert A. Hillman, Applying the United Nations Convention on Contracts for the International Sale of Goods: The Elusive Goal of Uniformity, *Cornell Review of the Convention on Contracts for the International Sale of Goods* (1995) 21-49. *It should be noted that even though Hillman applies Art. 84(2) in his line of reasoning, he argues that ultimately it is the general principles which warrant the application of disgorgement under the CISG.*

This solution would inevitably require a form of analogous application of Art. 84(2), since the provision deals with situations where the contract has been declared avoided, as the provision deals with restitution of benefits.²³⁰ We should bear in mind that no direct link exists between damages and restitution under the doctrine of the CISG. In fact, restitution of unjust gains is an alternative to the other remedies available to the injured party.²³¹ The CISG stipulates that restitution measures become available for parties only when the contract has been avoided.²³²

This approach would require analogical interpretation also, since Art. 84(2) stipulates that the buyer's duty in the said circumstance, as opposed to the seller's, is as follows: "The buyer must account to the seller for all benefits which he has derived from the goods or part of them".

Robert Hillman has argued that the underlying principles and aims of the Convention, such as encouraging to the completion of contracts, the promotion of trust and cooperation, supporting planning, and reducing transaction costs, should be interpreted to allow the analogous application of Art. 84 to the effect of allowing disgorgement of the seller's profits from selling to a third party.²³³

At least, we can say that based on Art. 84(2), the idea or the legal obligation of stripping a party from its actual profit is not entirely foreign to the CISG. Another issue I wish to touch upon here relates to the CISG Advisory Council Opinion No. 14, which is titled: "Interest Under Article 78 CISG".²³⁴ Issued in 2013, this Opinion is rather recent, and although it deals with a different provision from the one discussed here, it manages to explicitly connect Art. 84 to disgorgement. The following statement is made to that effect:

"Two different approaches to the award of interest must be distinguished: Whereas Article 84 has a restitutionary character and

²³⁰ Article 81(2) CISG stipulates the general applicability of restitution after avoidance of contract.

²³¹ CISG-AC Opinion No. 9, 'Consequences of Avoidance of the Contract', Rapporteur: Professor Michael Bridge, London School of Economics, London, United Kingdom. Adopted by the CISG-AC following its 12th meeting in Tokyo, Japan on 15 November 2008, at 1.5; Ulrich Magnus, The Remedy of Avoidance of Contract Under CISG - General Remarks and Special Cases, 25 *Journal of Law and Commerce* 2005-2006, at 423.

²³² Art. 26, Section V CISG; Magnus (n 231), at 426. See also Christiana Fountoulakis in: Schlechtriem & Schwenger, Schlechtriem Peter, Schwenger Ingeborg (Eds.), *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 3rd ed., Oxford 2010, at 1132, Art. 84 is meant to operate to restore parties to the economic position that they were in prior to the formation of the contract. It can be argued that this is so fundamentally different from disgorgement that the analogy is simply not plausible.

²³³ Hillman (n 229), at 36.

²³⁴ CISG Advisory Council Opinion No. 14, 'Interest under Article 78 CISG', Rapporteur: Professor Doctor Yesim M. Atamer, Istanbul Bilgi University, Turkey. Adopted unanimously by the CISG Advisory Council following its 18th meeting, in Beijing, China on 21 and 22 October 2013.

*reflects the idea of disgorgement, Article 78 follows similar principles to damages and aims at compensation.”*²³⁵

Although it may not seem like it at the first glance, that sentence has much to unpack. First of all, it is duly noted that the relevant context is about paying interest pursuant to Art. 78 and this alone might raise objections about the following points.²³⁶ However, the CISG Advisory Council, which consists of highly regarded experts, would surely never slip out such a statement by accident.²³⁷

What is noteworthy about the above-quoted sentence is that as opposed to suggesting that Art. 84 reflects the principle of unjust enrichment²³⁸ or any other more ambiguous legal principle, it states that the said provision reflects a distinct and quite controversial alternative remedy for compensatory damages. One instance of referring to ‘disgorgement’ in the Opinion is the following: “*Whenever disgorgement of accrued benefits is in the foreground, Article 84 applies.*”, which seemingly answers the question of which provision applies to disgorgement.

When we combine this with the comments provided in the CISG Advisory Council Opinion No. 10, which, in turn, recognizes the ‘paradigm shift’ in the law of damages towards emphasizing the role of damages in protecting party’s “*interest in the performance of the contractual obligations owed*”,²³⁹ it might not be unreasonable to wonder whether or not this implies that the views regarding the applicability of disgorgement under the CISG are in a flux.

Taking into consideration that disgorgement was not discussed during the drafting process of the CISG, it is highly notable for a group of experts to agree that certain provision of the Convention reflects the idea of disgorgement. Could it be that while Art. 74 reflects the principle of full compensation, Art. 84, in turn, could provide a safety valve for the

²³⁵ Id., at para 2. (emphasis added).

²³⁶ Incidentally, the issue of paying interest under the CISG was also discussed in the context and ultimately resolved through analogous application.

²³⁷ Ingeborg Schwenzer was the Chair of the Advisory Council which issued this particular opinion (No. 14). It is also noteworthy that the Opinion uses the term ‘disgorgement’ several times, leaving no doubt about the deliberateness of choosing the term.

²³⁸ Cf. Phanesh Koneru, ‘The International Interpretation of the UN Convention on Contracts for the International Sale of Goods: An approach based on General Principles’, 6 Minn. J. Global Trade 105 (1997), at 127; Ingeborg Schwenzer & Pascal Hachem, Article 7 in Schlechtriem & Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG), (3rd ed. Oxford University Press 2010), at 139.

²³⁹ CISG Advisory Council Opinion No. 10, Agreed Sums Payable upon Breach of an Obligation in CISG Contracts, Rapporteur: Dr. Pascal Hachem, Bär & Karrer AG, Zurich, Switzerland. Adopted by the CISG-AC following its 16th meeting in Wellington, New Zealand on 3 August 2012, at cmt. 4.3.4. The Opinion also makes a reference to the Attorney-General v Blake [2001] 1 AC 268 (H.L.), a famous common law disgorgement precedent.

execution of performance principle? Interestingly, this solution would fall along similar lines with the above-explained dynamics of the R3RUE, which at its core deals with restitution, but was supplemented with disgorgement as an ‘exception clause’ for unusual cases.

As the idea of granting disgorgement by applying Art. 84 has been floated far before the publication of the Opinion No. 14, the council members had to be aware of the existence of this line of reasoning. This also lessens the credibility of any suggestion that the mentioning of disgorgement in connection with Art. 84 bears no significance.

At this point, the above-examination on the part of individual remedial provisions of the CISG is sufficient to proceed to address principles guiding the interpretation of the CISG and their significance over this question.

6. Interpretation of the CISG Regarding Disgorgement

To introduce the interpretative framework of the CISG, we must turn to Art. 7, which sets out the guiding principles for the interpretation of the Convention. After explaining the article generally, this thesis will proceed to deal specifically with the general principles referred to therein.

6.1 Article 7 CISG

As stated, the CISG contains a specific provision that is meant to guide the interpreter of the Convention at his or her task. This provision, namely Art. 7 has been described as one of the most important of the Convention.²⁴⁰ Art. 7(1) of the CISG stipulates that:

*In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.*²⁴¹

We are able to observe that the Convention places three separate principles at the forefront of its interpretation doctrine: *recognition of the law's international character, a uniform application as a goal and promotion of the observance of good faith in international trade*. The wording of Art. 7(1) makes it clear that it is applicable only to the interpretation of the CISG, and not to the contract of the parties. However, this view has been contested with regard to the good faith principle, as there are existing views that advocate for the principle having a direct impact on the parties in the form of some requirements.²⁴²

The 'international character' essentially enshrines the principle of autonomous interpretation, whereby the text of the Convention must be read without any domestic preconceptions. Taking into consideration the nature of the CISG as representing a transnationally negotiated compromise between different legal traditions, it has been advised that 'great caution' needs to be utilized in its interpretation.²⁴³

²⁴⁰ Koneru (n 238), at 106.

²⁴¹ Art. 7(1) CISG.

²⁴² Schwenger and Hachem (n 238), at 122. Cf. Michael Joachim Bonell, C.M. Bianca and M.J. Bonell (eds.), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention*, Giuffrè, Milan, 1987, 65-94, at 84-85; Arthur Rosett, 'Critical Reflections on the United Nations Convention on Contracts for the International Sale of Goods', Vol 45 Ohio State Law Journal 1984, at para 3; Franco Ferrari, 'Uniform Interpretation of the 1980 Uniform Sales Law', 24 Georgia Journal of International and Comparative Law 1994-95, at 215; Anna Kazimierska, *The Remedy of Avoidance under the Vienna Convention on the International Sale of Goods*, Kluwer 1999-2000, at 169-171; Koneru (n 238), at 107.

²⁴³ Schwenger and Hachem (n 238), at 123. Cf. Ferrari (n 242), at 202, respectively argues that this principle should not translate to a narrow interpretation of the CISG; Greene, Stephanie M. and DiMatteo, Larry A.

The need to promote uniformity, in turn, means that regard should be had to foreign court decisions and arbitral awards when interpreting the CISG.²⁴⁴ These international decisions may have, if well-reasoned, persuasive authority and should subsequently be followed by other courts and tribunals. This attention to past decisions must be understood as an evaluation focused on specific problems arising from a given provision that is being interpreted.²⁴⁵

The third interpretation principle of Art. 7(1), the good faith principle, has undoubtedly been the most discussed one, as its significance and practical usage has been debated. This question and its possible effect on the interpretation regarding disgorgement will be addressed separately in the subchapter below, which deals with the general principles within the interpretation of the Convention.

Tentatively, the main issues as regards to the good faith principle under the CISG are: 1) its scope - in that whether it applies only to the text of the CISG and excludes the parties' contractual relationship and actions, or if it has a limited effect in the evaluation of the latter as well, 2) the difficulty to assign an accurately determined standard of 'good faith in international trade', and 3) whether or not a requirement to observe good faith in international trade could, in conjunction with Art. 7(2), have significance in the context of gap-filling, and if so, to what extent. In any case, it has been strongly argued that Art. 7(1) cannot be utilized to establish additional rights or obligations outside the interpretation of specific provisions.²⁴⁶

Relating to the themes of this thesis, *Schwenzer* and *Hachem* have asserted that:

“Comparative law as an interpretation method must be used with great caution. The requirement established by Article 7(1) that solutions are to be found which are acceptable in different legal systems with different

and Dhooge, Lucien J. and Maurer, Virginia G. and Pagnattaro, Marisa Anne, *The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence* (October 19, 2004). *Northwestern Journal of International Law & Business*, Vol. 24, No. pp. 299-440, 2004, (hereinafter: DiMatteo et al.), at 315 (holds that the presumption should be that CISG provisions are to be interpreted broadly).

²⁴⁴ See also Franco Ferrari, *Have the Dragons of Uniform Sales Law Been Tamed? Ruminations on the CISG's Autonomous Interpretation by Courts in: Andersen Camilla B., Schroeter Ulrich G. (Eds.), Sharing International Commercial Law across National Boundaries: Festschrift for Albert H. Kritzer on the Occasion of his Eightieth Birthday*, London 2008, pp. 134- 167, at 139 (where likewise 'uniformity' is said to trigger the requirement of autonomous interpretation).

²⁴⁵ *Schwenzer and Hachem* (n 238), at 124-126.

²⁴⁶ *Id.*, at 127-128.

legal traditions nevertheless requires carving out common grounds in the field of international trade."²⁴⁷

Therefore, the route forward in any question requiring interpretation of the CISG should be to try and 'carve out common ground' in international level.

6.2 Gap-filling Under the CISG

This subchapter will briefly introduce the operation and dynamics of gap-filling of the CISG in general. Although some might argue that the question concerning disgorgement does not even constitute a gap that requires interpretation, the case is that, as the CISG governs damages and restitution, the disgorgement issue was not discussed when the Convention was drafted and as the matter is not expressly settled in the CISG, there exists the need to evaluate this issue pursuant to the rules set out in the CISG for such questions.

The gap-filling process under the CISG is prescribed in Art. 7(2):

"Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law."

Reading this subsection and its rule regarding gap-filling while bearing in mind the requirement of 'autonomous interpretation' of the Convention, it is apparent that only when it is established that general principles are of no use in filling a gap, is it appropriate to resort to domestic law. In other words, domestic rules are to be applied as an ultima ratio-solution, only when applicable general principles cannot be found.²⁴⁸

Naturally, Art. 7(2) is applicable only when a gap exists, since whenever specific provisions govern an issue, they are to be applied without the interpreter concerning himself with the general principles.²⁴⁹

²⁴⁷ Id., at 132. Also noting that documents such as UNIDROIT Principles and PECL "can... only provide a certain indication for the development of the law and thus be of use to support arguments made in court decisions or arbitral awards". Id., at 133.

²⁴⁸ Alejandro M. Garro, *The Gap-Filling Role of the UNIDROIT Principles in International Sales Law: Some Comments on the Interplay between the Principles and the CISG*, 69 TUL. L. REV. 1149 (1994-1995), at 1159; Schwenzler and Hachem (n 238), at 134.

²⁴⁹ Lucia Carvalhal Sica, *Gap-filling in the CISG: May the UNIDROIT Principles Supplement the Gaps in the Convention?*, Nordic Journal of Commercial Law Issue 1 (2006), at 6.

A general issue relating to gap-filling is that, ultimately, the tool is meant to guarantee the operability and relevance of the Convention so that it does not become obsolete over time as changes inevitably occur in the field of international sales of goods. In other words, gap-filling is an instrument of developing the CISG by adjusting it to answer questions that were not present during the drafting of the Convention.²⁵⁰

Hence, the argument which proffers that an issue such as disgorgement was not discussed at the time of the drafting and therefore it cannot be recognized under the CISG, simply does not suffice. It can still be taken as an indicator that the drafters might not have approved the particular instrument, but this is not the endpoint of any sophisticated analysis.

However, the general principles that are used in the gap-filling necessarily also influence the scope of the matters that are governed by the CISG, and if there are no identifiable principles from which new rules could be distilled, or if the detected principles are too vague for inferring a new rule for a specific situation, then that issue should not be regarded as governed by the Convention.²⁵¹ In this sense, theoretically it could be argued that disgorgement falls out of the scope of the Convention, but as it will be discussed below, there are various general principles underlying the CISG that do provide guidance for the interpreter on this matter.

6.3 Analogous Application

The gap-filling method of analogical application is based on the examination of CISG provisions in order to determine whether certain rules or solutions, found within those provisions, could be applied within adequately analogous contexts to resolve legislative gaps.²⁵²

The method reaches its limits, however, when the rule set out in an analogous provision is restricted to its specific context in such manner that its extension to other circumstances would be arbitrary and in contradiction with the intention of the drafters or with the purpose of the rule itself.²⁵³

²⁵⁰ Schwenger and Hachem (n 238), at 135.

²⁵¹ *Id.*

²⁵² John Felemegas, Introduction to text "An International Approach to the United Nations Convention on Contracts for the International Sale of Goods (1980) as Uniform Sales Law", produced in 2007 under the auspices of the Institute of International Commercial Law of the Pace University School of Law, edited by Dr. John Felemegas, at 26.

²⁵³ Bonell (n 242), at 78.

Felemegas makes a clear distinction between analogical application and using general principles in interpretation and contends that the former represents the ‘primary’ gap-filling tool,²⁵⁴ some others favor general principles as the primary method to fill a gap or ambiguity.²⁵⁵ Then there are those who suggest that: “*The two levels of the interpretive discourse are likely to merge in most application. It is the recognition and application of general principles underlying specific CISG articles that make analogical reasoning a functional methodology.*”²⁵⁶

An interesting observation regarding this issue is that as the general principles’ interpretative influence apply to the entire CISG, and as they can be used to uncover implied principles that underlie individual provisions, these principles are to be used for guiding the interpretation of specific CISG provisions. This entails analogical reasoning in order to make sure that article-specific interpretations fit within the larger framework of the CISG.²⁵⁷

The analogical application is generally considered as an appropriate tool for gap-filling in certain cases,²⁵⁸ and it also meets the requirement of interpreting the CISG autonomously, since it exclusively relies on the text of the Convention. It is worth noting that this method has also been applied in various cases decided under the CISG.²⁵⁹ Finally, one test for the applicability of this method has been outlined in the following manner: “*in considering whether the case(s) expressly regulated by it and the case at hand are so analogous that it would be inherently unjust not to adopt the same solution for them*”.²⁶⁰

6.4 General Principles in Gap-filling and Interpretation

This chapter will explain how the general principles influence the CISG’s interpretation generally. Because of disgorgement’s relative novelty in the context of the CISG and its

²⁵⁴ Felemegas (n 252), at 26.

²⁵⁵ See generally Bonell (n 242), at 79; Koneru (n 238).

²⁵⁶ DiMatteo et al. (n 243), at 314.

²⁵⁷ Id.

²⁵⁸ See Gert Brandner, ‘Admissibility of Analogy in Gap-filling under the CISG’, [1999] Pace Law School Institute of International Commercial Law, at para 2; Jan Hellner, Gap-filling by analogy. Art. 7 of the U.N. Sales Convention in Its Historical Context, Studies in International Law: Festschrift til Lars Hjerner, Stockholm (1990), at para 2; Bonell (n 242), at 78; Enderlein & Maskow (n 219), at 58; John Felemegas, ‘The United Nations Convention on Contracts for the International Sale of Goods: Article 7 and Uniform Interpretation’, Pace Review of the Convention on Contracts for the International Sale of Goods (CISG) (2001), at para 3-4; DiMatteo et al. (n 243), at 313; Nives Povrzenic, Interpretation and gap-filling under the United Nations Convention on Contracts for the International Sale of Goods, at para 4; Schwenzler and Hachem (n 238), at 136.

²⁵⁹ See e.g. Supreme Court, Poland, 11 May 2007; Austria, Oberster Gerichtshof [Supreme Court], 18 December 2002; Vienna Arbitration proceeding SCH-4318, 15 June 1994.

²⁶⁰ Bonell (n 242), at 79. Cf. Ferrari (n 242), at 222.

nature as governed but not expressly settled by the CISG, the issue relies heavily upon how to interpret and apply different general principles in relation to it.

Also, as we have been able to infer, the text of the Convention does not render much support for granting disgorgement, whereas some of the general principles and derivatives of them, to some extent, might speak in favor of allowing disgorgement under the CISG.²⁶¹ This realization alone makes it necessary to concentrate on the operation of general principles in the interpretation of the CISG in our analysis.

The role of general principles must be discussed also because, irrespective of the specific method through which the disgorgement issue will be resolved, the general principles will influence the interpretation process.

In the interpretation of the CISG, general principles operate in such a way that when a legal question is examined from the perspective of general principles, it means that the individual provisions are observed as a part of the Convention as a whole.²⁶² By promulgating the importance of general principles via Art. 7, the CISG adheres to a type of 'holistic' interpretation, in which there are underlying values (general principles) that will guide the reading of individual provisions.

An arguably important reason for this sort of dynamic interpretation doctrine is the original goal of the CISG to become a uniform and autonomously operating body of law. This can be inferred from both subsections of Art. 7, as 'international character' and uniformity are emphasized and as the recourse to domestic law is reserved only as a last resort.²⁶³

Except for the ones enumerated in Art. 7(1), the Convention does not provide any list of the general principles. Therefore, general principles can only be found by interpreting the wording of CISG provisions and by examining case law and legal literature, where general principles have been established by judges and scholars.

It is useful to bear in mind that the general principles may also be used in further uncovering of implied principles underlying specific provisions of the CISG.²⁶⁴ A simplistic example of this in relation to disgorgement would be as follows: by interpreting Art. 84 in light of the principles that arguably flow from the good faith principle, Art. 84 could

²⁶¹ See Schwenger (n 20), at 1017.

²⁶² André Janssen and Sörren Clas Kiene, 'The CISG and Its General Principles' in Janssen A and Meyer O (eds), *CISG Methodology* (Sellier European Law Publishers 2009 pp. 261 –286), at 285.

²⁶³ See Bonell (n 242), at 75.

²⁶⁴ DiMatteo et al. (n 243), at 313-314.

be interpreted as reflecting disgorgement (or embodying the principle that one must not benefit from one's wrong) and applied to allow disgorgement. However, that interpretation, or any 'gap-filling' solution for that matter, cannot be in contradiction with other equally important general principles, which might be the case in the example above.

It might seem that using general principles to derive additional general principles from individual provisions creates an endless process or chaotic system, which could be used to construct almost any conclusion that one wishes. However, the important boundaries and safeguards from such arbitrary interpretations are also present in the general principles as they eventually pose hard limits for the interpretation. Consequently, the crucial discussion is about what these general principles are, how much leeway they provide and to what extent can the interpreter deviate from one general principle to emphasize another.

In conclusion, the best interpretative methodology is one that includes, and if needed, applies both methods: analogical application and the interpretative guidance of the general principles.²⁶⁵ As established, both methods are, in many respects, entwined as for their practical usage.

²⁶⁵ Anna Kazimierska (n 242), at 172.

7. General Principles of the CISG and Disgorgement

This chapter's objective is to lay out and explain the potential influence and interaction of different general principles, which are the most closely linked and, as such, can reasonably be deemed to have the greatest impact regarding this thesis' subject matter. The general principles that will be discussed in detail are the good faith principle and the principle of full compensation. In addition, the principle of uniform application will be touched upon briefly. These principles shall be discussed in order to proceed to the eventual completion of this thesis and drawing conclusions.

A considerable emphasis will be put on the good faith principle, as it is specifically mentioned as a guiding principle in Art. 7(1), and especially for its argumentative value regarding this thesis' subject. This is because the said principle's content and role under the CISG has been extensively debated both during and after the drafting process and because the arguably universal maxim of prohibiting a breaching party from benefiting from its wrong can be seen as flowing from the principle.

In addition, the debate regarding good faith offers an interesting and, perhaps, a revealing viewpoint as it represents the CISG's 'international character' as a compromise between different legal traditions.²⁶⁶

7.1 What General Principles the CISG Entails?

Before proceeding to the most crucial general principles for our purposes, I will first briefly introduce the framework that is composed of the different general principles. This should provide us with the appropriate context and emphasize the comprehensive and diverse nature of the doctrine.

It must be understood that from diverse and often conflicting general principles can be derived a myriad of conclusions. The aim of the interpreter should, in any case, remain to produce as coherent of a result possible that conforms with all of the core tenets of the

²⁶⁶ This particular circumstance might explain the debate regarding the inclusion of the principle that took place during the drafting of the CISG. It should be noted that, in some shape or form, 'good faith or fair dealing' principles exist in most prominent legal systems. See John Honnold, 'Documentary History of the Uniform Law for International Sales' (1989), at 298: "*It was pointed out that such principles are expressly stated in many national laws and codes and that it was thus appropriate that similar provisions be found in international Conventions. It was also pointed out that such provisions on good faith and fair dealing contained in national laws had in some legal systems become useful regulators of commercial conduct.*"

Convention. I should point out that the following presentation of the different general principles is not an exhaustive one.

Principles that are deemed as having a general nature and are manifested in Part 1 of the CISG are said to be: party autonomy, the promotion of observing good faith and estoppel (i.e. the prohibition of contradictory behavior) and the freedom of form. In Part 2, one can find the general principle of protection of a party's reasonable reliance caused by the other party, and in Part 3, there is the principle of party equality and the CISG's neutrality in that respect.²⁶⁷

The general principle of upholding contracts (i.e. favor contractus) can be derived from the restrictive rules on avoidance of the contract (Articles 25, 49, 64). Art. 74 is perceived to enshrine the general principle of full compensation, whereas Art. 77 establishes a general obligation to avoid and mitigate losses and disadvantages. The general rule that a party relying on certain facts must also bear the burden of proof can be held as a general principle as well. Art. 84, in turn, is said to establish a general principle of restricting unjust enrichment gained in a failed sales transaction.²⁶⁸

Several scholars also point to a general principle of reasonability under the CISG.²⁶⁹ In fact, there are 38 instances where a standard of reasonableness is imposed in the provisions of the CISG.²⁷⁰ Although arguably a vague principle, reasonability can still provide a type of overall measuring tool when weighing different choices that the interpreter is faced with. The reasonability standard is also applied to the conduct of the parties by virtue of several provisions of the CISG.²⁷¹

In some sense, the principle of reasonability resembles and supplements the good faith principle as it can be argued that reasonability, on a general level, would also require good faith behavior from the parties. Specifically relating to disgorgement, it could be argued on the basis of reasonability, that the fact alone that the claimant struggles to produce unquestionable proof of its loss should not automatically free the defendant from all liability.

²⁶⁷ Schwenzler and Hachem (n 138), at 136-137.

²⁶⁸ *Id.*, at 138-139.

²⁶⁹ Bonell (n 242), at 80-81; Brandner (n 258), at Para 2.A.2; Ferrari (n 242), at 225; DiMatteo et al. (n 243), at 317, 320.

²⁷⁰ *Id.*, at 317-318.

²⁷¹ See *id.*

Despite the fact that many general principles were not mentioned, the examples given above should reflect the complexity of this doctrine. With that in mind, we can begin to examine the weight and guiding influence of specific general principles in relation to disgorgement.

7.2 The Principle of Good Faith

This subchapter elaborates on the process of including the good faith principle into the CISG, as well as the different interpretations of it and its application. This subchapter will also discuss the arguments that can be invoked in support of disgorgement and that are stemming from this principle.

7.2.1 History and Content of Good Faith Under the CISG

During the drafting of the CISG, the issue of good faith was debated intensively.²⁷² The scope, influence, and manner of good faith's implementation into the Convention was a subject of substantial division.²⁷³ The eventual outcome was that the concept of good faith was incorporated into the Convention but located to the provision guiding the interpretation (Art. 7) so that its influence would be restricted to the interpretation of the CISG itself.

However, as time has passed since the drafting of the CISG, there have been voices among scholars suggesting that good faith could also have some influence in assessing the parties' contract and behavior.²⁷⁴ Depending on whom one asks, this phenomenon reflects either growing or creeping influence of good faith in the interpretation of the CISG. Reflecting this development, the good faith principle has been applied in various circumstances in case law, some of which might be seen as stepping outside of the confines of purely interpretative usage (or as neglecting the principle of uniformity).²⁷⁵

²⁷² Enderlein & Maskow (n 219), at 53.

²⁷³ Honnold (n 266), at 369, 476; John O. Honnold, 'Uniform Law for International Sales under the 1980 United Nations Convention', (4th Edition, eds Harry M. Flechtner) Kluwer Arbitration (2009), at 134; Koneru (n 238), at 138-139.

²⁷⁴ See Bonell (n 242), at 84-85; Rosett (n 242), at para 3; Ferrari (n 242), at 215; Kazimierska (n 242), at 169-171; Koneru (n 238), at 107.

²⁷⁵ Arbitration Court of the Chamber of Commerce and Industry of Budapest 17 November 1995; Constitutional Court of Columbia 10 May 2000; Helsinki Court of Appeals, 26 October 2000; OLG München 14 January 2009; Appellate Court Navarra 27 December 2007; Renard Constructions (ME) PTY LTD v. Minister for Public Works, 26 New South Wales Law Reports 234 (1992); France 22 February 1995, Appellate Court Grenoble (*BRI Production "Bonaventure" v. Pan African Export*).

As established, the CISG does not include a freestanding obligation to act in good faith.²⁷⁶ Article 7(1) is not generally regarded as requiring the parties to act in good faith. It simply inserts the doctrine of good faith to the interpretation dynamic of the CISG, but arguably not in the legal relationship between parties.²⁷⁷ The drafting history and the text of the CISG are said to reflect this view: “*general duty to observe good faith and fair dealing was explicitly not included in the CISG as agreement could not be reached*”.²⁷⁸ It has also been argued that this kind of obligation was not set because it could have created confusion and undermined the CISG’s objective of harmonization of law as the different domestic standards might have led to uncertainty.²⁷⁹

Some have noted that rulings which have deviated from this dynamic, resulting in importing a substantive obligation of good faith, usually reflect a ‘homeward trend’.²⁸⁰ The homeward trend can be described as the interpreter’s tendency to project aspects of the domestic law of the interpreter onto the provisions of the Convention.²⁸¹ Such decisions could also threaten the uniform and autonomous interpretation of the CISG.²⁸² In addition, it should be noted that applying domestic preconceptions to interpret the CISG is contrary to the autonomous application of the Convention.²⁸³ Thus, one should be cautious in examining any domestic case law, such as the Blake case, for example, when interpreting the CISG.

²⁷⁶ Steven D. Walt, ‘Modest Role of Good Faith in Uniform Sales Law’ in: 8 Virginia Public Law and Legal Theory 2014, 37-73, at 42.

²⁷⁷ Honnold (n 273), at 135; Huber & Mullis (n 219), at 8; Peter Schlechtriem, ‘Article 7’ In: Schlechtriem, Peter and Schwenger, Ingeborg (eds.), Commentary on the Convention on the International Sale of Goods (CISG) 2nd Edition, Oxford University Press, Oxford, 2005, pp. 93-110, at 95.

²⁷⁸ Camilla Baasch Andersen, ‘General Principles of the CISG – Generally Impenetrable?’ In: Anderson, Camilla B. and Schroeter, Ulrich G. (eds.), Sharing International Commercial Law Across National Boundaries: Festschrift for Albert H. Kritzer on the Occasion of his Eightieth Birthday, Wildy, Simmonds & Hill Publishing, United Kingdom, 2008, pp. 13-33, at 30.

²⁷⁹ See Alejandro M. Garro, Reconciliation of Legal Traditions in the U.N. Convention on Contracts for the International Sale of Goods in: 23 International Lawyer 1989, 443-483, at 465-468; Disa Sim, ‘The Scope and Application of Good Faith in the Vienna Convention on Contracts for the International Sale of Goods’, in: Pace Database, 2001, at para §VI.

²⁸⁰ Id., at §IV; Schwenger and Hachem (n 238), at 127-128.

²⁸¹ Harry M. Flechtner, Joseph M. Lookofsky, Nominating Manfred Forberich: The Worst CISG Decision in 25 Years In: Vindobona Journal of International Commercial Law and Arbitration, vol. 9, no. 1, 2005, pp. 199-208, at 202; Franco Ferrari, Homeward Trend: What, Why and Why Not In: CISG Methodology, Sellier European Law Publishers, Munich, 2009, pp. 171-207, at 181.

²⁸² Franco Ferrari, Gap-Filling and Interpretation of the CISG: Overview of International Case Law In: Vindobona Journal of International Commercial Law & Arbitration, vol. 7, 2003, pp. 63-92, at 65.

²⁸³ Id., at 68.

One possible source that should be addressed briefly is the UNIDROIT Principles, of which it has been stated that they may not fill gaps in the CISG unless ‘the relevant provisions...are the expression of a general principle underlying CISG’.²⁸⁴ It has been argued that because the UNIDROIT Principles have deviated from the CISG in supporting an explicit obligation of good faith, it would be questionable to use them to inform the content of the CISG on this issue.²⁸⁵

But even if a positive obligation of good faith existed under the CISG or would come to exist in the future, it is needless to say that this alone would not translate to disgorgement of profits for breach of contract. Rather, it could still be argued that the party who created the benefits, for example, through a second sale by breaching the contract, should be made to fairly allocate those profits.²⁸⁶

However, the question of whether or not the principle should be applicable to the relationship of the parties is of a limited relevance in the respect of this thesis because there is no uncertainty about its potential applicability in possible gap-filling and analogical application processes.²⁸⁷

The fact that the good faith principle cannot create additional rights or obligations for the parties,²⁸⁸ might satisfy some to conclude that, consequently, disgorgement cannot be allowed under the CISG for its nature as a ‘new’ remedy regarding the application of the Convention hitherto. However, the issue is more complicated than that and requires more delicate scrutiny. If disgorgement could emerge under the CISG, it is granted that this could not flow from the principle of good faith alone. Rather, the guiding influence of the principle might allow a CISG provision or another to be applied to that effect. The immediate question relating to this is whether or not the provision applied to that effect would transform beyond recognition in the process. In this case, such a solution should be rejected.

²⁸⁴ Michael J. Bonell, ‘An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts’, Transnational Publishers, New York, 2005, at 320; Katharina Boele-Woelki, Terms of Co-Existence: The CISG and the UNIDROIT Principles In: Šarčević, Peter and Volken, Paul (eds.), The International Sale of Goods Revisited, Kluwer Law International, New York, 2001, pp. 203-241, at 234.

²⁸⁵ Schwenger and Hachem (n 238), at 128. See UNIDROIT Principles 2010, Article 1.7 (“(1) Each party must act in accordance with good faith and fair dealing in international trade. (2) The parties may not exclude or limit this duty.”).

²⁸⁶ Schmidt-Ahrendts (n 20), at 94, 99.

²⁸⁷ See Felemegas (n 258), at para 5(ii); Ferrari (n 242), at 223; Bonell (n 242), at 79; Enderlein & Maskow (n 219), at 59; DiMatteo et al. (n 243), at 315.

²⁸⁸ See Bruno Zeller, ‘Good Faith - The Scarlet Pimpernel of the CISG’, (2000) [at: <http://www.cisg.law.pace.edu/cisg/biblio/zeller2.html#N>].

A persistent problem with the good faith principle, which is also consequently a cause of the denial of the principle's significance, has been and will continue to be the difficulty to accurately define the principle into having a particular meaning. This, of course, is not obtainable as the nature of the concept is inherently abstract and relative. However, there are specific principles that can be regarded to some extent as derivatives of the good faith principle that can be more precisely determined and applicable in practice. These will be discussed below in a separate subchapter.

Although an elusive term, good faith should not be considered as impossible to define. *Paul Powers* has proposed a working definition of good faith, that is, "international in character and captures the essence of various domestic definitions":

*"The duty of good faith can be defined as an expectation and obligation to act honestly and fairly in the performance of one's contractual duties. A certain amount of reasonableness is expected from the contracting parties."*²⁸⁹

While recognizing the fact that this definition refers to good faith as a duty and moderately extends its applicability to contracting parties as opposed to keeping the principle's function solely attached to interpretation, it nevertheless offers a tangible and more comprehensive perspective for the interpretative viewpoint as well.

7.2.2 The Divide Between Civil- and Common Law Perceptions of Good Faith

Powers explains that there is a distinction between civil- and common law regarding the concept of good faith. According to Powers, "*civil law states tend to use a more expansive approach to the good faith obligation, applying it to both contract formation and performance*", whereas "*common law states prefer a [narrower] good faith duty applicable to contract performance*".²⁹⁰

For the most part, these differences of approach on a global scale led to the debate about good faith at the drafting of the Convention. Consequently, a working group was constituted and it proposed a compromise that would protect the Convention's international character while promoting uniformity and good faith as well.²⁹¹ This compromise, like

²⁸⁹ Paul J. Powers, 'Defining the Undefinable: Good Faith and the United Nations Convention on the Contracts for the International Sale of Goods', 18 J. L. & COM. 333-353 (Spring, 1999), at 334.

²⁹⁰ Id., at 335-342.

²⁹¹ Id., at 343.

the CISG as a whole, was ultimately aimed to suit both civil- and common law doctrines so the solution would be acceptable in different legal systems.²⁹²

Another consequence of this compromise regarding the remedial doctrine of the CISG was that the Convention accommodates both the right to claim specific performance (more widely available in civil law systems) and the right to claim monetary damages (favored in common law systems).²⁹³ These remedies are offered to the aggrieved party without attaching priority to either one over the other.²⁹⁴

To summarize: the important commonality between the two most prominent legal traditions of the modern world regarding the concept of good faith is that the principle is generally seen as requiring honesty and reasonableness in the contract performance to which a party has bounded itself.²⁹⁵ In this sense, it could be argued that the controversy of interpreting good faith in similar fashion under the CISG might have been exaggerated out of proportion. Another important notion regarding this thesis is the apparent connection of this definition of good faith and disgorgement in that also the latter is conventionally seen as requiring honesty and fairness in the contract performance.

When examining the definitions of good faith in the UCC and the Restatement (Second) of Contracts, in different civil law systems, in the UNIDROIT Principles and even in the context of the CISG, it is observable that, while the definitions might vary, the same underlying idea is present: at minimum, contracting parties must act in some manner of good faith in their contract performance.²⁹⁶

An intriguing phenomenon relating to this issue is that in the U.S, which is a common law country where good faith is traditionally conceived more restrictedly as is the right

²⁹² Sieg Eiselen, 'The CISG as Bridge between Common Law and Civil Law' In: DiMatteo Larry A. (Eds.), *International Sales Law: A Global Challenge*, Cambridge 2014, 612-629, at 613.

²⁹³ Steven Shavell, 'Specific Performance Versus Damages for Breach of Contract', Harvard John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 532 - 11/2005, at 22-26; See Art. 45 CISG (although, CISG stipulates the following qualifier for awarding specific performance (Art. 28 CISG): *If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgement for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by this Convention.*

²⁹⁴ Michael G. Bridge, 'The International Sale of Goods', 3rd ed., Oxford University Press 2013, at 601.

²⁹⁵ Powers (n 289), at 335-341; see id., at 338, of civil law: "This obligation extends to contract performance and requires parties to act reasonably, or more specifically, not to breach the relationship of trust with those with whom they negotiate and contract"; See id., at 340, of common law: "Although the application may be different under the common law, the meaning is essentially the same as in civil law states. Good faith requires parties to perform their obligations under the contract fairly, honestly, and in a manner acceptable in their trade or business.". Also in past socialist states' legal systems included the concept of good faith, see Larry A. DiMatteo, 'The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Dealings', 22 *Yale J. Int'l L.* 111 (1997), at 148.

²⁹⁶ Powers (n 289), at 351.

to specific performance, steps have been taken towards more distinct recognition of disgorgement as has been referenced above. At some level, this would seem counterintuitive, but perhaps it serves as an example of the constantly developing character of the precedent-driven legal tradition the U.S is part of. One apparent reason for the above-described developments in the U.S, especially observable in the R3RUE, could be the common law's persistent rejection of penalty clauses in contract law.²⁹⁷

7.2.3 More Tangible Derivatives of Good Faith Principle

In addition to good faith being explicitly mentioned as a general principle of the Convention and specific provisions exemplifying the good faith principle, such as provisions dealing with preservation of goods and mitigation of damages,²⁹⁸ it can be argued that certain maxims in contract law are inherently connected with this principle.

One such maxim is that a party should not benefit from breaching its duty to perform. As good faith can be defined by what it is not, and while the concept of bad faith is not necessarily an integral part of the analysis, it can be relied upon to highlight what is definitely not a good faith performance.²⁹⁹ Thus, there is a strong argument that if good faith is to be taken seriously as an underlying principle of the CISG, consciously benefiting by breaching one's obligation should be prohibited and to the extent possible, subsequently deterred.

In relation to this, *pacta sunt servanda*, which is an age old legal principle, can either be seen as representing this same idea, but only on a more general level or it can be understood as a separate principle supporting the above-described maxim. In any case, the profound ideas that contracts should be honored and that the innate character of contracts as binding renders some verification to the concept of disgorgement. After all, when *pacta sunt servanda* demands performance in circumstances in which the act of performing has

²⁹⁷ Joseph M. Perillo, 'Unidroit Principles of International Commercial Contracts: The Black Letter Text and a Review', 63 *Fordham L. Rev.* 281 (1994), at 313-314. In the U.S. however, U.C.C. §2-718(1) provides a limited exception to the rule concerning unenforceability of penalty clauses by allowing courts to enforce a liquidated damage clause if the amount of actual damages is difficult to ascertain and the liquidated damages reasonably reflect the approximate of actual damages.

²⁹⁸ Amy H. Kastely, 'Unification and Community: A Rhetorical Analysis of the United Nations Sales Convention', 8 *Nw. J. Int'l L. & Bus.* 574 (1988), at 597.

²⁹⁹ See Zeller (n 288), at Part 2, (i)-(iii); Robert S. Summers, 'The General Duty of Good Faith - Its Recognition and Conceptualization', 67 *Cornell L. Rev.* 810 (1982), at 829.

become onerous to the extent of causing loss,³⁰⁰ it should evidently demand performance in circumstances where a party could achieve higher profits by breaching.

By virtue of this principle, once a contract has been concluded, the parties are expected to fulfill their obligations. From this point of view, the breaching party is not granted the ‘Holmesian’ option of either paying damages or performing. Rather, in civil law, this option is given to the injured party as he or she can also demand specific performance.³⁰¹

7.2.4 The Principle of Good Faith and Disgorgement

It is evident that the principle of good faith and fair dealing enshrined in Art. 7(1) can be evoked in support of a claim for disgorgement of profits. It is also clear that the said principle should be applied with caution, as we have gathered that it cannot bring about entirely novel rights and obligations under the Convention. Instead, the principle influences the existing content of the CISG.

Should disgorgement emerge in the future, it would not flow directly from the good faith principle, but probably through a broader conception of full compensation interpreted with regard to the demands set by the good faith principle. As remedies exist, to a large extent, to protect what the parties bargained for i.e. the performance of the contract and as they should also reflect the aim to promote a trust-based system, the argument in support of disgorgement, based on the principle of good faith, should be considered seriously and meticulously.

In conclusion, there are powerful arguments for allowing a claim for disgorgement under the CISG. However, the potential deterrence-effect of disgorgement as well as other desirable impacts must be regarded in the framework that consists of all general principles of the Convention. Thus, I will next examine the principle of full compensation before drawing the final conclusions of this thesis.

³⁰⁰ See UNIDROIT Principles Article 1.3, Article 6.2.1: “...even if a party experiences heavy losses instead of the expected profits or the performance has become meaningless for that party the terms of the contract must nevertheless be respected.”.

³⁰¹ Admire Takawira, ‘Departing from mere compromise: Reformulating the remedy of specific performance under the Convention on the International Sale of Goods (CISG) in line with the Convention's underlying goals’, Pace Law Web Article, November 2007, at chapter 3.1. See also Steven Walt, ‘For Specific Performance Under the United Nations Sales Convention’, 26 Tex. Int'l L. J. 211-251 (1991), at 218; Alan Schwartz, ‘The Case for Specific Performance’ (1979). Faculty Scholarship Series. Paper 1118, 271, at 305.

7.3 The Principle of Full Compensation

The principle of full compensation underlying Art. 74 CISG has been already introduced in the chapter dealing with remedial provisions of the CISG. Therefore, this subchapter will deal with the said principle specifically in relation to disgorgement.

The full compensation principle is well established and its core content, which is in placing the injured party in the same economic position in which it would have been if the contract had been performed, is applied in various legal systems around the world. Simply put: the principle is meant to provide full compensation to the aggrieved party for all losses resulting from breach of contract.

Although, the text of Art. 74 clearly stipulates that damages consist of a sum *equal* to the loss, and while the full compensation principle undoubtedly is based on this specific stipulation, it should be seen as the general rule regarding damages instead of barring further interpretations of different provisions or placing rigid hard limits thereof. The interpretative influence of the principle should necessarily deviate from a strict rule of black letter text as that is essentially how all principles operate: to be encompassingly and pervasively applicable, a certain degree of abstraction is required.

The main issue concerning the principle of full compensation and disgorgement is naturally the implicit effect of prohibiting overcompensation as full compensation reaches its limits when the actual loss is compensated. This limitation is behind the unavailability of punitive damages under the CISG. There exists a consensus that because punitive damages aim at the punishment for outrageous behavior instead of compensation, they may not be awarded under Art. 74 CISG.³⁰²

Disgorgement, for its part, is often depicted as being based on a punitive rationale.³⁰³ Occasionally, the remedy is described as ‘supra-compensatory’, for its partial independence from provable, actual loss of the injured party.³⁰⁴ Thus, the idea that disgorgement is incompatible with the principle of full compensation can be easily understood.³⁰⁵

³⁰² CISG Advisory Council Opinion No. 6, 9B, 9.5.

³⁰³ See Katy Barnett, ‘Accounting for profit for breach of contract, Theory and Practice’, Hart Publishing, Oxford 2012, at 12, 15; see also Lord Hobhouse’s dissenting opinion in *Attorney General v. Blake* [2001] 1 AC 268. 2001 (H.L.).

³⁰⁴ See Schmidt-Ahrendts (n 20), at 93; Francesco Giglio, ‘Restitution for Wrongs: A Structural Analysis’ in: 5 *The Canadian Journal of Law & Jurisprudence* 2007, 5-34, at 6.

³⁰⁵ Although, it is debated whether disgorgement is punitive by nature. See generally. chapter 4 of this thesis above.

One perspective that should not be overlooked when analyzing this line of reasoning is the appropriate differentiation between the core tenet of the full compensation principle i.e. total reparation and the prohibition of overcompensation as a derivative rule. It should be acknowledged that the principal character of full compensation is the purpose of guaranteeing the injured party's right to receive compensation for all losses. And indeed, even in legal systems which allow punitive damages, the general concept of contract damages is based on the concept of full compensation.³⁰⁶

However, this is not to imply that the CISG would not contain the prohibition of punitive damages. I argue that the effect of disallowing 'overcompensation' is, while a logical corollary, still a derivative in relation to the core objective of the full compensation principle.

It seems that this derivative nature is also observable in the previously referenced opinions of *Schwenzer*, who posits that as the aggrieved party is already disadvantaged from the outset, punitive elements have to be included to guarantee full compensation of the aggrieved party³⁰⁷ and that "penal elements can also play a role despite the fact that the Convention does not allow awarding punitive damages".³⁰⁸

Should one adopt the categorical viewpoint that 'punitive' as a term and qualification accompanies any remedy that deviates from the strict requirement for equivalence between loss and compensation, then one would perceive disgorgement as punitive. However, this view seems unnecessary rigid when compared, for example, to the rule that the amount of loss needs to be proven only with reasonable certainty, which necessarily leaves leeway regarding the said equivalence. The argument that disgorgement represents a form of punitive damages, and as they are prohibited under the Convention, it is the end of the story, is not adequately complex of an analysis.

Generally, the principle protects the aggrieved party's right to be compensated for all disadvantages suffered as a result of a breach of contract.³⁰⁹ However, as we know, the specifics of the principle are not that simple. 'All disadvantages' can be understood to entail a myriad of different things. Without an in-depth analysis of how the expectation

³⁰⁶ See generally Gotanda (n 38).

³⁰⁷ See Ingeborg Schwenzer and Pascal Hachem, 'The Scope of the CISG Provisions on Damages' in Saidov D and Cunnington R (eds), *Contract Damages: Domestic and International Perspectives* (Hart Publishing 2008 pp. 91–106), at 102-103.

³⁰⁸ Schwenzer (n 20), at 1001.

³⁰⁹ Schwenzer (n 20), at 1001; CISG-AC Opinion No. 6, para 1.

of a party is construed, it is widely recognized that there are, for example, many forms of harm that do not easily translate into economic terms.

The Advisory Council's Opinion No. 6 states that Art. 74 CISG does not allow for awards that result in the promisee being in a better position than it would have been had the contract been performed.³¹⁰ There are factors, however, that may lead to the factual under-compensation of the injured party. The reality of quantifying the amount of all the disadvantages caused to the injured party is seldom as straightforward as in theory. Difficulties imposed in the practical process, as well as the legal restraints set out for damages, may lead to compensation being less than 'full'.³¹¹

It can be argued that the application of a strict approach regarding the principle is not entirely supported under the CISG. Indeed, certain disadvantages that are not visible on the balance sheet should be deemed recoverable.³¹² For reference, the PICC 2010 and PECL mention non-pecuniary damage as compensable.³¹³

Therefore, I would regard the strict prohibition of overcompensation, to some extent, as a question open to interpretation. This is also due to the interpretative framework of the Convention that is based on *numerous* general principles and the consequent notion that the principles of good faith and *pacta sunt servanda* should also be considered when interpreting the CISG. As has been previously explained, disgorgement is not punitive per se,³¹⁴ but intends to demotivate a party from breaching by introducing the possibility that the breach might be futile (instead of punishable) in a business sense. The uncertain proportion of 'overcompensation' could be regarded as an unintended and secondary by-product of the remedy.

I would argue, for example, that granting disgorgement would not be contradictory as regards the full compensation principle in circumstances where the risk of the achieved profit actually being higher than the loss is only relatively small. Some might argue that this would only represent a quantification method for damages rather than disgorgement, but to some extent, this example should suggest that the prohibition of overcompensation is not absolute.

³¹⁰ CISG Advisory Council Opinion No. 6, para 9.5.

³¹¹ There are other requirements for damages, namely foreseeability (of Art. 74 CISG) and the burden of proof set upon the non-defaulting party.

³¹² Schwenger and Hachem (n 308), at 94-95.

³¹³ Art. 7.4.2(2) PICC; Art. 9:501(2)(a) PECL.

³¹⁴ Hillman (n 229), at 37.

Nevertheless, the opposing view should not be omitted either: it can be argued that the right to claim compensatory damages is a sufficient, as well as exhaustive, expression of *pacta sunt servanda* under the CISG and, thus, any additional remedies, such as disgorgement, are not required.

7.4 Uniformity of Application

One important general principle still to be addressed in this analysis is one of the three explicitly mentioned in Art. 7(1), namely the principle of uniform application of the CISG.

As established, the need to promote uniformity in the application of the CISG translates into the practice of having regard for foreign courts decisions and arbitral awards where the CISG has been applied. Previous rulings and the reasonings they contain may have persuasive authority. In this case, they should be followed by subsequent interpreters. This reference to previous rulings should be understood “*as evaluating foreign decisions and arbitral awards when it comes to specific problems arising from the provision to be interpreted.*”³¹⁵

To some extent, this principle could eventually go both ways with regard to disgorgement. On one hand (and axiomatically), the decision in the Adras case has been criticized on the basis of it endangering the uniformity of the international sales law,³¹⁶ but on the other hand, there might be a tipping point in the development of different domestic laws regarding disgorgement, after which the uniformity of the CISG might be jeopardized by way of courts resorting to domestic laws instead of trying to find appropriate solution within the CISG.³¹⁷

However, due to the fact that there are very few precedents with persuasive authority allowing disgorgement of profits under the Convention, the uniformity of application should be viewed as tilting towards more conservative and, subsequently, restrictive interpretation in this matter. The interpreters of the CISG will likely be cautious in their conclusions as regards granting any form of disgorgement, as there exists only limited support for resolving a ‘hard case’ in favor of disgorgement, arguably even when the circumstances at hand would render such considerations relevant and appropriate.

³¹⁵ Schwenger and Hachem (n 238), at 124-126.

³¹⁶ Adar Yehuda, ‘Israel’, in: DiMatteo Larry A. (editor), *International Sales Law, A Global Challenge*, Cambridge University Press, New York 2014, 518–538, at 523; Reich (n 81); Schlechtriem (n 82), at 11.

³¹⁷ See Schwenger and Hachem (n 238), at 95. Cf. Felemegas (n 258), at chapter 3.

This presumption was defied by an arbitration case in 2007 which was decided by applying the CISG and administered by the Stockholm Chamber of Commerce. The breaching party's profits (the amount of the buyer's sales from a two-year period) were ordered to be handed over to the aggrieved party as a form of compensation.³¹⁸ An interesting aspect regarding this case is that, to a large extent, the award was influenced by the fact that the breach was that of a confidentiality clause and the breach also involved exploitation of protected information of the aggrieved party in the form of IT-source code.³¹⁹

These aspects also merge rather distinctly with some of the considerations that have been put forth elsewhere within the discourse regarding disgorgement. Also, in a world in which different forms of information are ever more valuable but simultaneously difficult to put a price on in varying contexts, the questions as to quantification of appropriate compensation might begin to coalesce with the straightforward and arguably fair method of quantification provided by disgorgement.

It would seem that the award was made with significantly more interest over the question of what the breaching party gained from the breach rather than what the actual loss in that case was. It remains questionable whether the final award actually equaled with the loss of the injured party. Then again, perhaps compensatory damages would have been inadequate from the perspective of the injured party. In any case, the award serves as an example of how varying cases are decided under the CISG. I would rather invoke this case in calling for a broader discussion about this issue instead of attaching excessive authority to it.

³¹⁸ Pressure sensors case (Stochholm Chamber of Commerce Arbitration), 5 April 2007.

³¹⁹ *Id.*, at paras 147-168, 170-174. Also in the Blake case, there was a breach of 'restrictive covenant' and there are similar elements with the fiduciary doctrine when confidential information is involved.

8. Conclusions

To begin with the final remarks of this thesis, I would point out that the so-called legal environment from which the R3RUE arose had much in common with the different doctrines of the CISG. If disgorgement should become feasible under the CISG, I argue that it would require a further and more principled reading of Art. 84. This could grant it a distinctly recognized feature as embodying a general principle favoring disgorgement. As noted above, there might already be some signs of this happening.

As we recall, the disgorgement rule of the R3RUE stems jointly from doctrines of restitution and damages. Now, as Art. 84's reading seems to have evolved from constituting the general principle of unjust enrichment to 'reflecting the idea of disgorgement', it might not be wholly unreasonable to consider the prospect of the CISG adopting or tolerating some of the ideas manifested in the R3RUE as time goes by. As regards the CISG, possible changes in the interpretation of the relevant provisions and principles might also be contingent on further developments of different domestic legal systems, of which there are already examples at this point, the U.S. put aside.³²⁰

As for the R3RUE, it remains to be seen, whether it signals a genuinely significant development within American contract law, and much will rely on the large-scale reception of the updated Restatement by the U.S. courts. But in any case, this recent development regarding more established and explicit support for disgorgement in the U.S. should not be disregarded. The changes may not be rapid or even conclusive, but, perhaps, they should persuade the international sales law community to take another look at the CISG in the light that is cast by the developments in the R3RUE.

As a contingent notion, the principle regarding damages as essentially aiming at compensation by virtue of Art. 74 should, nevertheless, affect the possible application of disgorgement so that it would only be available when the conventional remedy of compensating the calculable loss of the injured party fails to provide adequate protection for his or her performance interest. This would also be in line with the reasoning in the R3RUE.

The reality is that the requirement for uniform application of the CISG makes it difficult for a single court or tribunal to draw the conclusions that would have to be drawn in order to establish a precedent in regard of disgorgement. And rightly so. In addition, the cases

³²⁰ Schmidt-Ahrendts (n 20), at 96; Israel & O'Neill (n 194), at 6; Arts. 6:78, 6:104 Dutch Civil Code.

where there would be reasonable grounds for even making a claim for disgorgement are in all likelihood in short supply.

I would argue that the best way forward would be a specific CISG Advisory Council Opinion, that, if drafted in a balanced manner, could lend restricted or conditional support for granting disgorgement in certain exceptional cases. Even if such support would be seen as unattainable or unwarranted, the Advisory Council could at least clarify the most paramount issues to consider in cases in which compensatory damages appear to be inadequate.

At this point, the CISG Advisory Council Opinion No. 6 has taken the stance that over-compensation must be avoided when awarding damages. This also supports the view that for disgorgement to be awarded under the CISG, it would require further interpretation or analogical application of Art. 84 or certain general principle therein. It should be noted that the Advisory Council's Opinion No. 6 specifically and exclusively analyzed the appropriate interpretation and quantification of damages and, quite understandably, did not attempt to provide an encompassing interpretation of the entire remedial doctrine or address the disgorgement issue explicitly.

Recourse to the domestic law being an ultima ratio measure within the doctrine of the CISG should also push the authorities of the Convention into pursuing an articulated and more convincing conclusion on this matter. After all, the relief valve of Art. 7(2) should not be interpreted as an easy path around the challenging task to determine the correct interpretation of the text and the general principles of the CISG.

As regards the question of good faith in international trade, the U.S. is the only common law country that has included good faith into its statutory regime.³²¹ Section 1-203 of the UCC states that "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."³²² From this perspective, it is worth noting that the U.S, in particular, has forwarded the above-described developments regarding disgorgement.

In passing, it is also noteworthy that the new Contract Law of the People's Republic of China has likewise included the principle of good faith into several articles. Article 6,

³²¹ Bruno Zeller, 'Good Faith - Is it a Contractual Obligation?', *Bond Law Review* Vol 15, Issue 2 (2003) 215-239, at 215.

³²² This was reinforced in section 205 of the Restatement of Contracts (Second), where a duty of good faith and fair dealing was also imposed on the parties in contract performance and enforcement.

referred to as the most important one, reads: “The parties shall abide by the principle of honesty and good faith in exercising their rights and performing their obligations.”³²³

What is remarkable in the theory/remedy of disgorgement is that it boldly and markedly challenges the good faith principle to its core. It electrifies the debate around the content, usage, and utility of the principle as the idea of disgorgement can be seen as creating a type of litmus-test in posing the question of whether a principle intended to promote honesty, trust, protection of reasonable expectations and co-operation can be simply put aside in order to uphold a certain long-standing rule.

Despite these considerations, an honest recognition of disgorgement’s nature as an outlier is in place. However, it is often the case that the outliers or ‘hard cases’ provide the most fruitful viewpoint through which the weighing of different legal principles can occur.

Finally, should an interpretation prevail that under the CISG, disgorgement of profits is simply not feasible as regards to the full compensation principle, I am confident that all interested parties would welcome a more comprehensive analysis of the general principles arriving at such a conclusion.

As a final remark, I would entertain a possible compromise solution of allowing courts to use their discretion on this matter in a similar fashion as they are able to do with specific performance. Specific performance, like disgorgement, is a remedy that might be considered appropriate in some legal systems but not in others. The fact that the Convention allows specific performance has not caused significant problems or friction among different member states. Arguably, one reason for this is the limitation of Art. 28, according to which a court is not bound to order specific performance unless the court would do so under its own law.

Analogical application of this provision to disgorgement would naturally require, in the first place, the conclusion that in some cases disgorgement could be awarded under the Convention. Specific performance was and is viewed quite differently among the signatory states. It was debated at the time of drafting the CISG,³²⁴ and the outcome was that the remedy shall be subjected to a discretionary review of a court as to whether a specific relief would be granted under the court’s domestic law.

³²³ Zeller (n 321), at 216; Contract Law of the People's Republic of China, Chapter I, Article 6.

³²⁴ See generally Walt (n 301).

Should disgorgement be allowed in some limited set of circumstances, given the above-discussed connections and similarities between specific performance and disgorgement awards, for example, as regards specific interest in unique goods or other circumstances that might render monetary damages insufficient,³²⁵ the limitation of Art. 28 might serve to restrict the above-mentioned ‘sweeping implications’.³²⁶

In summary, this thesis’ aim was to draw necessary attention to certain national tendencies and universal legal theories relating to wider acceptance of disgorgement of profits in contract law. The writer’s contention is that based on the general principles of the CISG the possible applicability of disgorgement as an ultima ratio remedy should not be ruled out categorically. However, such application should necessitate further recognition of Art. 84 as enabling this function, and possibly an analogous limitation to that of Art. 28.

³²⁵ *Cunnington* identifies five situations regarding specific performance: Cases where there is no market substitute, cases where damages are too difficult to quantify, cases where the breaching party will not be able to pay damages, cases where only nominal damages are available and cases where the type of loss is not recoverable, Ralph Cunnington ‘The Inadequacy of Damages as a Remedy for Breach of Contract’ in Charles EF Rickett *Justifying Private Law Remedies* (Hart Publishing, Oxford, 2008) at 115.

³²⁶ Roberts (n 17), at 142.